

Chapter 7 Trustee's Perspective: Selling Litigation in Bankruptcy is Prohibited?

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By James M. Hoffman

A Chapter 7 bankruptcy trustee may receive the opportunity to pursue a large claim for an avoidable transfer, such as a fraudulent conveyance, a preferential transfer or a pre-petition claim that the debtor holds. However, such litigation may be expensive to pursue and there may be a large risk of loss. Should the trustee engage in “Bet the Farm” litigation at the trustee’s personal financial risk when outside counsel will not accept the case on a contingency fee basis and there are no other assets in the Estate? Should the trustee abandon the claim to the detriment of the creditors? The best alternative may be to sell the litigation, but is the sale barred by old common law principles?

This scenario involves the principles of maintenance, champerty and barratry (the “Principles”), which trace back supposedly to ancient Greece. The Supreme Court found that 1) maintenance is helping another prosecute a suit; 2) champerty is maintaining a suit in return for a financial interest in the outcome, and 3) barratry is a continuing practice of maintenance or champerty. *In re Primus*, 436 U.S. 412, 425 (1978). The Principles were intended to prevent the manufacturing of frivolous or vexatious litigation.

The fifty states are not uniform in their treatment of the Principles, with some states upholding the common law doctrines of champerty and maintenance in some form^[1] and others having abolished the doctrine altogether or not recognizing it.^[2] According to the Fourth Circuit, most jurisdictions no longer recognize causes of action for damages based on champerty and maintenance and such actions arose only where the alleged wrongdoer had no interest in the litigation. [*American Hotel Management Associates, Inc. v. Jones*, 768 F.2d 562, 570 \(4th Cir.1985\)](#), but Maryland still does. See *Rojas v. Huntington Neighborhood Ass’n*, No. DLB-21-28, 2022 WL 616815, at *4 (D. Md. Mar. 1, 2022). Similarly, see *In re DesignLine Corp.*, 565 B.R. 341 (Bankr. W.D.N.C. 2017) (holding that a proposed agreement between trustee and entity that had agreed to finance trustee’s pursuit of litigation against debtor’s insiders was prohibited by champerty under North Carolina law and could not be approved.)

Of course, the bankruptcy court may need to address which state law to apply in any case. See *Koro Co., Inc. v. Bristol-Myers Co.*, 568 F.Supp. 280 (D.D.C. 1983) (the court determined that New York law of champerty, rather than New Jersey law, applied to invalidate the assignment of claims.) Also, see *Riffin v. Consol. Rail Corp.*, 363 F. Supp. 3d 569, 575 (E.D. Pa.), *aff’d*, 783 F. App’x 246 (3d Cir. 2019)

Barratry and the other Principles may be defined by statute in some states and may cover a multitude of sins. See e.g. Md. Bus. Occ. & Prof. Code Ann. § 10-604(b).^[3] As stated by the District Court of Maryland, the conduct proscribed by the current statute was first made a statutory offense in Maryland in 1908. “Before then, the officious stirring up of, maintaining, or meddling in litigation in which a person had no interest constituted the common law crime of barratry, maintenance, champerty, or embracery, depending on the particular nature of the conduct.” *Abbott v. Gordon*, No. CIV.A. DKC 09-0372, 2011 WL 828646, at *17 (D. Md. Mar. 7, 2011). Both champerty and barratry require proof that the intermeddler expected to

personally gain from or share in the outcome of the litigation.

Now let's go back to our creative and diligent Chapter 7 trustee. In the case of [*In re Simply Essentials LLC*, No. 20-305, 2022 WL 1026045 \(Bankr. N.D. Iowa Apr. 5, 2022\)](#), the trustee proposed a sale of a potential worthwhile avoidance action against a creditor to another creditor that would litigate those suits in the best interest of the estate.

The trustee sought authorization to sell the right to bring avoidance actions under Chapter 5 of the Bankruptcy Code regarding preferential and fraudulent transfers. The trustee believed the claims could provide the estate with a large recovery, but the Estate could not afford to pursue them. The bankruptcy court approved a settlement under which the trustee would sell the Estate's right to bring avoidance claims to a creditor holding a \$23.4 million claim over the potential defendant's competing offer.

The Court overruled an objection that these claims were not included in "property of the estate" and recognized the practicalities of the situation stating that: "To allow parties otherwise facing meritorious ... avoidance claims to escape those claims because the trustee cannot afford to pursue them and they cannot be sold or transferred would be an absurd result." The court reasoned that [Section 541\(a\)\(7\)](#) of the Bankruptcy Code recognizes these claims as assets of the Estate that can be sold under [Section 363\(f\) of the Bankruptcy Code](#) and B.R. 9019(b).

Regardless of whether a debtor or creditor opposes or supports the sale of litigation in bankruptcy by a trustee, one should not forget to check the applicable statute or the common law Principles under governing law before making an argument to the court.

[1] These states include, among others, the bankruptcy-friendly Delaware and New York as well as Alaska, D.C., Florida, Kentucky, Maine, Maryland, Mississippi, New York and Pennsylvania.

[2] Arizona, California, Connecticut, New Jersey, New Hampshire, New Mexico, Oklahoma, Texas and recently Minnesota, among others, do not recognize the principles.

[3] (b) Without an existing relationship or interest in an issue:

(1) a person may not, for personal gain, solicit another person to sue or to retain a lawyer to represent the other person in a lawsuit;

(2) a person who is not a lawyer may not, for personal gain, access a report for the purpose of soliciting another person to sue or to retain a lawyer to represent the other person; and

(3) a lawyer, except as provided in the Rules of Professional Conduct, may not:

(i) for personal gain, solicit another person to sue or to retain a lawyer to represent the person in a lawsuit;

(ii) directly or indirectly employ or in any way compensate or agree to employ or compensate any person as an expert witness or otherwise for the purpose of having that person solicit or attempt to solicit clients for the lawyer;

(iii) knowingly represent a person who retained the lawyer as a result of solicitation prohibited under this section; or

(iv) cause a case to be instituted without the authority of a client.(c) Any solicitation involving acts described in this section is prima facie evidence that the person soliciting is acting for gain.

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