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Southwest Bankruptcy Conference

Business

Is Bankruptcy Dead?

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CONCURRENT SESSION

2022

SOUTHWEST BANKRUPTCY CONFERENCE

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Is Bankruptcy Dead?

FOUR SEASONS LAS VEGAS
LAS VEGAS, NEVADA

SEPTEMBER 8-10, 2022

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SOUTHWEST BANKRUPTCY CONFERENCE

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Kathy Bazoian Phelps

Esq. and Partner, Raines Feldman, LLP

Kathy Bazoian Phelps has been a lawyer since 1991 and is currently a partner at Raines Feldman, LLP in the Los Angeles office. Kathy practices in the area of insolvency law, fiduciary representation, and fraud litigation, and she serves as serving as a fiduciary herself. Kathy's practice includes representing federal equity and state court receivers and bankruptcy trustees, as well as serving as a receiver and trustee herself. Kathy frequently serves as special litigation counsel for fiduciaries and interested parties in fraud-related litigation and she is particularly knowledgeable about the administration of Ponzi scheme cases.

Kathy has lectured widely and written on bankruptcy and receivership matters, with a focus on Ponzi schemes. In addition to her roles as lawyer, speaker and author, Kathy also serves as a mediator and is currently on the mediation and arbitration rosters for the Financial Industry Regulatory Authority, as well as the Bankruptcy Mediation Panel for the Central District of California and the Bankruptcy Mediation Panel for the District of Arizona.

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Peter S. Davis

CPA, ABV, CFF, CIRA, CTP, CFE
JS Held Sr. Managing Director, Corporate Finance

Senior Managing Director, Peter S. Davis, has over 25 years of litigation experience in areas including complex receiverships, forensic accounting, restructuring, fraud detection, bankruptcy matters, valuations, and damages. Mr. Davis has served as Receiver in regulatory matters brought by the U.S. Securities and Exchange Commission, Federal Trade Commission, Arizona Corporation Commission, and the Arizona State Board of Education, as well as lenders and equity holders. His areas of expertise includes understanding and interpreting complex financial data, fraud detection, turnaround, and determining damages. Mr. Davis has provided expert testimony in numerous Federal, Bankruptcy, and State court matters. He has taught on the subject of forensic accounting and receiverships at Arizona State University and has provided training on forensic accounting and receivership to numerous organizations.

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Kyra Andrassy

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Kyra Andrassy is a partner with Smiley Wang-Ekvall, LLP. Her practice focuses on representation of companies in financial distress, creditors, creditors' committees, receivers, and assignees of assignments for the benefit of creditors. She is currently conference co-chair for the ABI Bankruptcy Battleground West conference and the annual conference for the National Association of Federal Equity Receivers. She is a director of the Los Angeles Bankruptcy Forum, the National Association of Federal Equity Receivers, and the Southern California chapter of the International Women's Insolvency & Restructuring Confederation. She is a member of the Executive Committee of the Business Law Section of the California Lawyers Association. Ms. Andrassy served a judicial clerkship to the Honorable John E. Ryan (ret.), United States Bankruptcy Judge for the Central District of California and a member of the Ninth Circuit Bankruptcy Appellate Panel.

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M. Elaine Hammond
United States Bankruptcy Judge
Northern District of San Jose, CA

M. Elaine Hammond is a United States Bankruptcy Judge for the Northern District of California in San Jose. A native of North Carolina, she received her undergraduate degree from Duke University, and her JD with honors from the University of North Carolina School of Law. Prior to taking the bench in 2012, Judge Hammond's practice focused on representing debtors and creditors in commercial bankruptcy cases and out-of-court restructurings. She was a partner with the San Francisco firm Friedman Dumas and Springwater LLP. Prior to that she was an associate with Murphy, Sheneman, Julian & Rogers LLP. Judge Hammond began her legal career as a law clerk for the Judge Edward D. Jellen (ret.), also of the Northern District of California.

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Asset Sales

- 363 Sales in Bankruptcy
- State Receiver
  - For real estate, new uniform receivership law
- Federal Receiver
- Assignment for the Benefit of Creditors Sales "ABCs"
- Article 9

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Non-Payment to Lender

- Rents and profits preservation and collection:
  - Bankruptcy
    - Single Party Disputes
    - Adequate Protection Issues
  - State Court Receivership
  - Federal Receiver
  - Assignment for the Benefit of Creditors

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Business/Partnership Disputes

- Bankruptcy
- Chief Restructuring Officer – Disputes between Debtor and Lender
- Independent Board or Director
- State Court Receiver
- Assignment for the Benefit of Creditors and Federal Receiver

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Reorganization Plans for Ongoing Business

- Who are the interested parties and classes of creditors?
- Chapter 11 in Bankruptcy
- Assignment for the Benefit of Creditors
- State Court Receiver
  - Restructure to rehabilitate business for sale
  - Cannabis
- Uniform Law
- Federal Receiverships: Equitable plans, but often liquidating
- Out of court Restructuring

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Other Considerations

- **Avoidance Actions**
  - **Fraudulent Transfer**
    - Bankruptcy Code
    - State Statutes for Receiverships and Assignment for the Benefit of Creditors
  - **Preference**
    - Bankruptcy Code
    - Assignment for the Benefit of Creditors
    - State statutes

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Other Considerations

- **Attempts to preclude insiders from filing bankruptcy:**
  - Can state court receiver orders take that right away from management?
  - Can you prevent involuntary bankruptcy filing?
  - Federal receiverships
- **Protecting Professionals**
  - Court supervision
  - Barton doctrine?
  - Special Purpose Entities for Assignment for the Benefit of Creditors

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Other Considerations

- **Litigation Claims**
  - In pari delicto – difference for trustees and receivers

IS BANKRUPTCY DEAD?

ABI SOUTHWEST CONFERENCE

SEPTEMBER 9, 2022

By:

M. Elaine Hammond, U.S. Bankruptcy Judge, Northern District of California

Kyra Andrassy, Smiley Wang-Ekvall, LLP

Peter Davis, J.S. Held, LLC

Kathy Bazoian Phelps, Raines Feldman, LLP

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ABI Southwest

IS BANKRUPTCY DEAD?

September 9, 2022

What are the alternatives to a bankruptcy filing?

ARTICLE 9 SALES

I. Generally

Foreclosure sales under Article 9 of the Uniform Commercial Code can be a useful tool where a company is in default on secured debt, reorganization is not feasible, and the lender is willing to be involved in disposition of the collateral.

UCC § 9-610(a) provides that after default (which is defined not by the UCC but by the loan documents) "a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing." This gives the lender a great deal of flexibility.

UCC § 9-610(b) provides that "Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms."

II. The Mechanics

The secured creditors must give notice to certain parties of its intention to sell the collateral, and notice must be "a reasonable authenticated notification of disposition." UCC § 9-611(b). Notice must be sent to the debtor, any secondary obligor on the debt, any other parties claiming a lien against or interest in the collateral. UCC § 9-611-(c). Ten days' notice is sufficient for a non-consumer transaction. UCC § 9-612. The notice must describe the debtor and the secured creditor, the collateral proposed to be disposed, the method of the intended disposition, and must state that the debtor is entitled to an accounting of the unpaid debt, the charge for the accounting, and the time and place of a public disposition.

Proceeds are first used to pay the reasonable expenses of the disposition of the property, including reasonable attorney's fees and legal expenses incurred by the secured party, next to the obligations secured by the collateral, next to junior lienholders if they make a demand for proceeds before distribution of proceeds is completed and, if proceeds remain, to the debtor. UCC § 9-615.

III. Advantages

- Buyers take the assets free and clear of liens, even if the secured party fails to comply with Article 9 (unless the buyer isn't a good faith buyer)
- If done cooperatively, it is a quick and efficient method for disposing of collateral, costing less than a 363 sale in a bankruptcy case and on a shorter timeline.

• The foreclosure is not public, so if the foreclosure does not involve all assets and the company remains an ongoing operation, it may avoid damage to its reputation because unsecured creditors do not have to be notified.

ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

I. Generally

Every state has some form of an assignment for benefit of creditors, which is essentially a liquidation under state law. In some states, it is judicially supervised but in others (like California), it is not. A company assigns all of its assets to an assignee, which accepts them, liquidates them, and then distributed proceeds to creditors.

Assignments are not a vehicle for a reorganization and are instead only used in liquidations. Assignees are inherently risk adverse and will operate a business for only a short period of time if they can ensure that the benefits will exceed the costs of doing so and it is necessary to preserve value. Many times, sales of the assets are teed up in advance of the actual assignment so that the assignment and the sale occur virtually simultaneously. Other times, the assignee may run a sale process once the assignment occurs.

Much like in a bankruptcy, proceeds are used to pay secured creditors with valid liens against the collateral, and then priority debts such as taxes and wage claims, and then to trade creditors. There is a claims process similar to a bankruptcy proceeding.

II. Advantages

• Avoids the expense and scrutiny of a chapter 7 trustee

• It's a more efficient and expeditious way of liquidating a business

• In some states, the assignee may have the ability to recover preferential payments in the ninety days prior to the assignment and fraudulent transfers made by the assignor

III. Disadvantages

• If a secured creditor is involved, the assignee either needs to be comfortable that the value of the assets exceeds the secured debt or the secured creditor must consent in advance to the assignment and subordinate its lien to the administrative expenses of the assignment estate.

• There is generally no automatic stay, so litigation against the company that is the subject of the assignment can continue.

• If property is in multiple jurisdictions, an assignment may not be the best avenue because the assignment might not include property in other jurisdictions which would instead be the subject of the laws of the state on which the property is located.

• Creditors dissatisfied with the outcome of the sale through an assignment may file a fraudulent transfer action and try to force the buyer to pay more or unwind the deal

•The sale does not have the force of a federal court order authorizing the sale free and clear of liens

• There is no discharge of debt as there might be in a liquidating chapter 11 where there are some limited business operations after confirmation of the plan.

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• There is no cap on certain claims, like lease rejection damages

STATE OR FEDERAL RECEIVERSHIPS

I. Generally

A receiver is a neutral fiduciary whose powers and responsibilities are defined by the documents or order appointing them. They are almost always judicially appointed. Receivers are not appointed in the interest of the company but are instead appointed in the interests of creditors or shareholders, who are the parties with authority to seek appointment of a receiver.[1]

The scope of the duties of a receiver are typically defined by the appointment order, and the receiver is an officer of the court.

Where there is federal jurisdiction, a federal court may appoint a receiver after taking into consideration the following factors: (1) existence of fraudulent conduct, (2) the validity of the claim of the party seeking the appointment, (3) whether there is an imminent danger that assets will be lost, damaged, dissipated, or decreased in value, (4) the inadequacy of alternative remedies, and (5) the likelihood that a receiver will do more good than harm. *See Aviation Supply Corp. v. R.S.B.I. Aerospace, Inc.*, 999 F.2d 314, 316-17 (8th Cir. 1993).

II. Mechanics

Typically, an action to appoint a receiver is initiated by litigation brought by either (1) a secured creditor whose contracts authorizes it to seek a receiver as one of the remedies for default, (2) a creditor where collateral is at risk of being dissipated or not maintained or the business is being mismanaged and assets dissipated, or (3) by shareholders who file an action to dissolve a corporation and seek the appointment of a receiver to assist in that process, typically because of a dispute between the shareholders. It can also be a post-judgment enforcement remedy. The receiver is generally appointed to take over control and management of property that is the subject of litigation before the court. It is an ancillary remedy, not an independent action. A receiver appointed to take possession of and satisfy creditors from the debtor's assets is referred to as a general or equity receiver; a receiver appointed over specific collateral is a custodial receiver, also referred to as a rents and profits receiver.

The scope of a receiver's duties depends on the relevant statutes and largely on the appointment order. It is critical that the appointment order lists the specific duties of the receiver and which actions the court authorizes the receiver to take to perform those tasks and whether further court approval is required. Ideally, it should also impose a stay against any actions by third parties that may affect the receivership property.

Receivers have the right to take and keep possession of all receivership property but may dispose of it only by court order and according to the directions of the court. They serve until performance of their duties is complete or the litigation out of which their appointment was made has been resolved.

III. Advantages

[1] Federal regulatory receiverships have different characteristics and are not discussed in these materials.

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• Can be used not just to liquidate or wind down a business but, in certain circumstances, to reorganize or stabilize a business. It is a very useful tool for closely held corporations with disagreements between owners on major business decisions.

• If real property is involved and for any number of reasons, the debtor is having difficulty obtaining loans to address issues at the real property that are required to preserve or increase value, receivers in most states have the ability to issue "certificates of indebtedness," also known as receiver's certificates, to lenders who extend further credit and to give them a priority claim against the property.

•It is typically less expensive than a chapter 11 because there are fewer procedural requirements than a chapter 11 case and fewer parties involved.

• Because cannabis companies cannot yet avail themselves of the protections of the Bankruptcy Code, state court receiverships are often the only option for reorganization or a liquidation.

IV. Disadvantages

• State courts typically only have jurisdiction over property located within the state, so a company with assets of multiple estates may not be the best candidate because ancillary receiverships will be required in other states. Federal courts can exercise jurisdiction over assets in other states as long as a notice of receivership is filed in the other jurisdictions within a specified time frame. *See* 28 U.S.C. § 754.

• If transparency is the goal, receiverships are less transparent than bankruptcy cases because there is no requirement that a debtor file a schedule of assets or liabilities or a statement of financial affairs, and state court pleadings may not be as readily available as federal filings are.

• Unless the receivership order provides that only the receiver may initiate a bankruptcy filing, the appointment of a receiver may drive a company into a bankruptcy filing. Another way to prevent a bankruptcy filing may be to have the appointment order give the receiver the sole authority to pick a new board of directors for the corporation. If the receiver does so, then the directors who are replaced have no authority to initiate a bankruptcy case. *See Sino Clean Energy, Inc. v. Seiden (In re Sino Clean Energy, Inc.)*, 901 F.3d 1139 (9th Cir. 2018).

• Even if the state court receivership order contains a provision staying litigation, that may not be enforceable by a creditor taking action in a different state, and that creditor may not be forced to deal with its claim in a single forum as it would if a bankruptcy case were filed.

• Receivers may not have the authority to assume, assign or reject executory contracts as one would in a bankruptcy case, and a receiver may not be able to recover preferential payments.

• There may be limitations on the receiver's ability to sell assets free and clear of liens, claims, and encumbrances.

OUT OF COURT WORKOUTS OR LIQUIDATIONS

I. Generally

Typically, an out of court workout or liquidation involves a contractual agreement with a secured creditor or core group of creditors to restructure obligations by consent. It may involve an agreement to voluntarily discharge the remaining debt after certain payments are made. It can involve other cost-cutting measures, such as reducing overhead or obtaining new financing.

II. Advantages

• Typically less expensive than a chapter 11 or 7

• It is not subject to the publicity or transparency of a bankruptcy case

• Typically more efficient than a chapter 11

• Avoids the expense and scrutiny of a chapter 7 trustee (which may be a disadvantage for creditors)

II. Disadvantages

• It is not a practical solution if creditors are adversarial and not interested in coming to the table, nor is it a practical solution if there are a large number of trade creditors such that the logistics of reaching an agreement with them is unwieldy.

• Does not involve the transparency of a bankruptcy case and is not overseen by a fiduciary appointed by the court or the Office of the United States Trustee, and avoidance actions are not pursued.

• There is no ability to reject leases, so if a key factor in the successful restructuring is rejection of leases, this may not be a viable option.

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Faculty

Kyra E. Andrassy is a partner with Smiley Wang-Ekvall, LLP in Costa Mesa, Calif., where her practice focuses on the representation of companies in financial distress, creditors, creditors' committees, receivers and assignees of assignments for the benefit of creditors. She is currently conference co-chair for ABI's Bankruptcy Battleground West and the annual conference for the National Association of Federal Equity Receivers, and she is a director of both the Los Angeles Bankruptcy Forum and the Southern California chapter of the International Women's Insolvency & Restructuring Confederation. Ms. Andrassy is a member of the Executive Committee of the Business Law Section of the California Lawyers Association. She served on the board of directors for the Orange County Bankruptcy Forum from 2006 through 2009 and served as its president in 2009. She also served as the program chair of the Orange County Bar Association's Commercial Law and Bankruptcy Section in 2003, and as its section chair in 2004. Ms. Andrassy was recognized as a Southern California Rising Star in 2005, 2006, 2007, 2008, 2010 and 2011 and has been recognized as a "Super Lawyer" by *Los Angeles Magazine* each year since 2012. She served a judicial externship to Hon. Barry Russell of the U.S. Bankruptcy Court for the Central District of California in Spring 1998 and from September 1998 until September 2000, and a judicial clerkship to Hon. John E. Ryan, U.S. Bankruptcy Judge for the Central District of California and a member of the Ninth Circuit Bankruptcy Appellate Panel. Ms. Andrassy received her undergraduate degree in political science from the University of California at San Diego in 1995 and her J.D. from Loyola Law School in Los Angeles in 1998, where she served as an editor of the *Loyola Law Review*.

Peter S. Davis, CPA, CIRA, CTP, CFE is senior managing director of Corporate Finance at J.S. Held LLC in Phoenix and has more than 25 years of litigation experience in areas including complex receiverships, forensic accountings, restructurings, fraud detection, bankruptcy matters, valuations and damages. He has served as receiver in regulatory matters brought by the U.S. Securities and Exchange Commission, Federal Trade Commission, Arizona Corporation Commission and the Arizona State Board of Education, as well as lenders and equityholders. Mr. Davis's areas of expertise include understanding and interpreting complex financial data, fraud detection, turnaround and determining damages. He has provided expert testimony in numerous federal, bankruptcy and state court matters. Mr. Davis has taught on the subject of forensic accounting and receiverships at Arizona State University and has provided training on forensic accounting and receivership to numerous organizations. He is a member of ABI and a board member of the National Federation of Equity Receivers and the Arizona Bar Foundation. He also is a member of the American Bar Association, American Institute of Certified Public Accountants, Arizona Asian Bar Association & Arizona Black Bar, Arizona Society of Certified Public Accountants, Association of Certified Fraud Examiners, Association of Certified Fraud Examiners' Arizona Chapter, Association of Insolvency and Restructuring Advisors, California Receivers Forum, Commercial Receivers Association, International Association of Special Investigations Units Inc., Los Abogados Hispanic Bar Association of Arizona, Maricopa County Bar Association, National Association of Bankruptcy Trustees, National Association of Federal Equity Receivers, Secured Finance Network's Southwest Chapter, The Risk Management Association and the Turnaround Management Association. Prior to joining J.S. Held, Mr. Davis was a senior managing director with Simon Consulting, LLC. He received his B.S. in accouting in 1991 from Loyola Marymount University and his M.B.A. in 2001 from Arizona State University.

Hon. M. Elaine Hammond is a U.S. Bankruptcy Judge for the Northern District of California in San Jose. Prior to taking the bench in 2012, her practice focused on representing debtors and creditors in commercial bankruptcy cases and out-of-court restructurings. Judge Hammond was a partner with Friedman Dumas & Springwater LLP in San Francisco, and her private practice focused on representing both debtors and creditors in commercial bankruptcy cases and out-of-court restructurings. She represented Universal Music Group Distribution in numerous bankruptcies of music retailers, including Musicland and Tower Records. Prior to joining Friedman Dumas & Springwater LLP upon its founding in 2003, Judge Hammond was an associate with Murphy Sheneman Julian & Rogers and clerked for Hon. Edward D. Jellen (ret.) of the U.S. Bankruptcy Court for the Northern District of California. She received her undergraduate degree from Duke University and her J.D. with honors from the University of North Carolina School of Law.

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