



AMERICAN
BANKRUPTCY
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2019 Mid-Atlantic Bankruptcy Workshop

What's Your Role? Adult in the Room

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What's Your Role?: Adult in the Room

This session highlights the possible roles of financial advisors, investment bankers, examiners, local counsel, plan officers, and guardians during a bankruptcy process



Case Study – Able's Widget Manufacturing

The Debtor in this scenario is Able's Widget Manufacturing (the "Company" or "Able's"). The CEO took out a loan from Easy Bank for \$50mm as part of the purchase price for the business secured by the real estate. This property is co-owned with the CEO's brother, Rich. Rich consented to having the entire property pledged as collateral in exchange for \$3mm of junior debt and part of the equity in the Company. Easy Bank's loan has been paid down to \$30mm. The property currently appraises for \$24mm. Able's also secured a loan from Nice Bank for \$30mm to upgrade their equipment secured by M&E that is currently appraised at \$18mm, Inventory valued at \$5mm, and a second lien on the real estate. Able's does not offer terms to their customers so they have no AR.

One of Able's largest customers recently went out of business unexpectedly which significantly reduced their monthly revenue. Able's did not react quickly to that decline. As a result, they are behind on payments to both Easy Bank and Nice Bank and their accounts have been sent to each bank's work out department. Able's also owes \$550,000 in outstanding taxes to the county and owes trade vendors \$8mm with a DPO of +60days. The result is a severe working capital pinch point for Able's.



Possible Bankruptcy – Can equity holders save Able’s?

Able’s faces the real need to protectively file Chapter 11 bankruptcy unless the present equity holders can bridge the liquidity squeeze. Unfortunately, the stockholders consist of a diverse set of holders whose interests are not aligned with respect to the future prospects of the Company and their participation in that future. Additionally, the banks are unwilling to assume additional debt liability for the Company and they are reviewing daily disbursements before the Company is allowed to release them.

Rich would have been the most likely equity holder to provide bridge financing, however, Rich died unexpectedly in a plane accident and is survived by an only child, Young, who is only eight years old. The CEO is the physical Guardian of Young but Young’s court-appointed legal Guardian, the fiduciary of Rich’s estate, refuses to provide the Company additional financing finding that such an action is not in the best interest of Young who is the beneficiary of the estate.



What are the roles and responsibilities of a Guardian?

- Why are there two separate guardians for Young?
- What is the difference between a legal guardian vs. physical guardian?
- Is there a conflict of interest for the CEO to serve as a full guardian to Young?
- Why can’t the CEO use Young’s assets as a bridge financing for the Company?
- What are the advantages of having a separate legal guardian for a minor in a will?



Chapter 11 Bankruptcy: Possible Fraudulent Transfers

Without sufficient liquidity to pay wages and meet creditor demands, Able's banks and counsel determined the best course of action for the estate would be to pursue a 363-asset sale of the business in a Chapter 11 Bankruptcy filing. After the bankruptcy filing, the United States Trustee appointed an official committee of unsecured creditors (the "Committee") who hired counsel to represent their interest. Easy Bank and Nice Bank are both represented by their in-house counsel and outside counsel in the bankruptcy.

The Committee hired a financial advisor. The financial advisor alleges that the CEO commingled funds of Able's with two other companies that the CEO owns.

An Examiner was appointed by the court to investigate the Committee's allegations. The Examiner's final report found evidence of co-mingling of funds and preference payments made to the CEO's deceased brother, Rich.



What are some of the roles and responsibilities of an examiner?

- Why was an examiner hired?
- What are the benefits of hiring an examiner as opposed to a trustee in this situation?
- What is the difference between examiner vs. trustee?
- Can the examiner also be appointed as trustee in the same case?

What are possible next steps?

- Appoint a Trustee?
- Should the case convert to Chapter 7?
- Sue the CEO for mismanagement or fraud?
- Pursue actions to recover co-mingled funds and preference payments?
- Can the examiner pursue legal actions to recover these funds?
- Are the other companies owned by the CEO also in trouble? Would it make sense to file Chapter 11 for these entities and roll them up into one case?



Chapter 11 Bankruptcy: Chapter 11 Trustee Appointed

A Chapter 11 Trustee was subsequently appointed. To support the process, the Trustee hires a new bankruptcy counsel and an investment banker, Max Value, to manage the sale process.



Why did the Trustee hire these professionals?

- Why didn't the Trustee retain the Company's original counsel?
- Considering the Examiner's report, should the Trustee have continued with the sale process? Was that a prudent decision?
- What are the roles and responsibilities of Max Value as investment banker?
- Can Max Value help the Trustee pursue recovery of co-mingled funds or preference and avoidance actions?



Objections from Secured Creditors

The Debtor does not have the funds to pay the upfront expenses involved in the sale process and requested the banks fund those expenses. Both Easy Bank and Nice Bank filed objections to the retention of Max Value citing issues with the fee and expenses involved with the engagement.

The objections were overcome. The banks agreed to fund the expenses and Max Value's fee structure, and the court approved their retention. The next hurdle was to agree to a process timeline and bid procedures. Easy Bank wanted a longer process to maximize value on the real estate where Nice Bank wanted a quicker process as their collateral was deteriorating at a much faster pace.





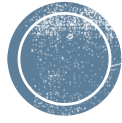
What are arguments that can be used to convince the banks it is in their best interest to fund the expenses and allow the sale process to move forward?

Being the Adult in the Room - Bringing “adult supervision” into a contentious bankruptcy process is critical to help avoid a less-than optimal result for all stakeholders.

Key Considerations

- Comparison of the going concern value vs. a liquidation value?
- Inter-creditor issues between the senior secured and junior lenders?
- WARN act concerns for all stakeholders?
- Development of a robust cash forecast to manage expectations vs. results?
- Retention of banks’ liens on proceeds of sale?
- Max Value failed to disclose to the Trustee that it had a relationship with the other entities owned by the CEO, though a very limited one.





What are some arguments that can be made to come to a compromise on the timeline?

- Inter-creditor claims creating potential delays?
- What is the cost for a longer vs. a shorter process?

Stalking Horse Bid

After several weeks, Max Value identified a buyer that submitted a stalking horse bid at an amount that would only pay off 70% of the outstanding debt but higher than liquidation value. Neither of the banks wanted to agree to the stalking horse offer as it wasn't going to pay off their loans in full.





What are some arguments that can be made to convince the banks to accept the stalking horse offer and proceed to seek the court's approval?

- What is the next best alternative available?
- Was the bidding process flawed?
- What is the cost to delay accepting the present bid?

363 Sale Bidding Process

Max Value presented the stalking horse bid to the market and secured an additional 3 bids for Able's assets by the bid deadline. The buyers had separate bid lots for each of the bank's collateral.

At auction, the purchase price increased to an amount that would pay off 90% of the outstanding secured debt but was significantly higher than liquidation value.

The Committee's attorney threatened to object to the sale because there wasn't anything allocated to the unsecured creditors.



What are some compromises that can be made?

- Can any of the proceeds be shared (“throw them a bone”)?
- There will be potential recovery actions made by the Trustee that could be allocated to all creditors.
- Can the banks agree to allocate some of the sale proceeds to the unsecured creditors?
- Are there potential insurance claims that could be pursued due to mismanagement?
- Are there unencumbered assets from the two companies owned by the CEO?



Objection from Easy Bank

At the auction, Easy Bank said they were not willing to carve out anything from their sale proceeds to pay for outstanding taxes, cost of sale, administrative claims or payment to unsecured creditors.





What are some arguments that can be made to help Easy Bank understand that it is in their best interest to cooperate so the sale can be approved?

- The Trustee could pursue the loan paydown previously made to Easy Bank as it could be deemed voidable should those payments have occurred when Able's was insolvent.
- There could be more funds available from the Trustee's recovery actions.

Objection from Losing Bidder

During the hearing to approve the 363 sale to the entity determined by the Trustee to be the winning bid, one of the losing bidder whose bid was \$2mm less than the winning bid, filed an objection to the approval of the sale, on the grounds that: (i) the Debtor or the Trustee conducted the sale in a manner that solely serves to ensure that the winning bid was selected; and (ii) failed to disclose certain documents and business information that if disclosed would have caused the bidder to increase its bid. In connection with this objection, the court grants the objector's request for discovery of all communication between the Debtor (Trustee) and each bidder as well as disclosure of the documents and financial information that objector believed was withheld. The discovery process became contentious and ugly between the parties.



What can the attorneys do to redirect this process?

- What if one or both sides refuses to produce certain relevant documents and counsel is aware?
- What is counsel's obligation to the court?
- Does counsel's obligations change if counsel is so-called Local Delaware counsel?
- What are the options available to the court?
- Sanctions? Denial of motion to approve sale?



Trustee's Recovery Actions

While the 363 sale was in process, the Trustee hired a financial advisor specialized in forensics, Forensics Pro, to initiate recovery actions. Forensics Pro conducted an in-depth forensic accounting of the Company's financials and traced the Company's co-mingled funds to the CEO's two other companies' bank accounts.

Able's has D&O insurance for the CEO. Forensics Pro provided expert testimony in support of the Trustee's lawsuit against the CEO for mismanagement and fraud, as the CEO has purposefully altered records and hidden from creditors and shareholders regarding these transfers.

The Trustee also pursued recovery of preference payments made to Rich and settled out of court with Young's Guardian.



What types of recovery actions can the Trustee pursue?

- Was it necessary to hire Forensics Pro?
- Should the Trustee involve other federal agencies to pursue criminal actions against the CEO? Will this help with the insurance claim?
- Should the Trustee have settled out of court with Young's guardian?



The Wrap Up

At last, the secured creditors and creditors committee agreed to how the sale proceeds were to be split and proceeded to the sale hearing, where the sale was approved and ultimately closed. Along the way all constituents had to make a compromise at some point because after a commercially reasonable sale process with competitive bidding, there weren't enough proceeds to make everybody whole, however if the sale didn't move forward resulting in a liquidation of the assets, there would have been even less proceeds to distribute. At every impasse it required one or more constituents to compromise in order to allow the process to move forward. There are times when certain parties may dig their heels in and refuse to budge, which requires someone to show how that behavior will ultimately result in nothing being accomplished. In most deals, someone from each party-in-interest will at one time or another have to be the adult in the room and show a member of their team why compromise will be in everybody's best interest.





**“You Can’t Always Get What
You Want but You Get What
You Need”**

Being the Adult in the Room