

Restructuring Opportunities & Pitfalls for Litigators and Deal Lawyers

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Meet the Team



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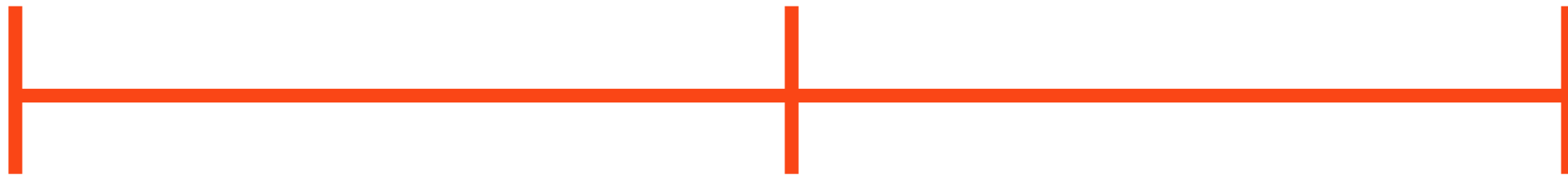
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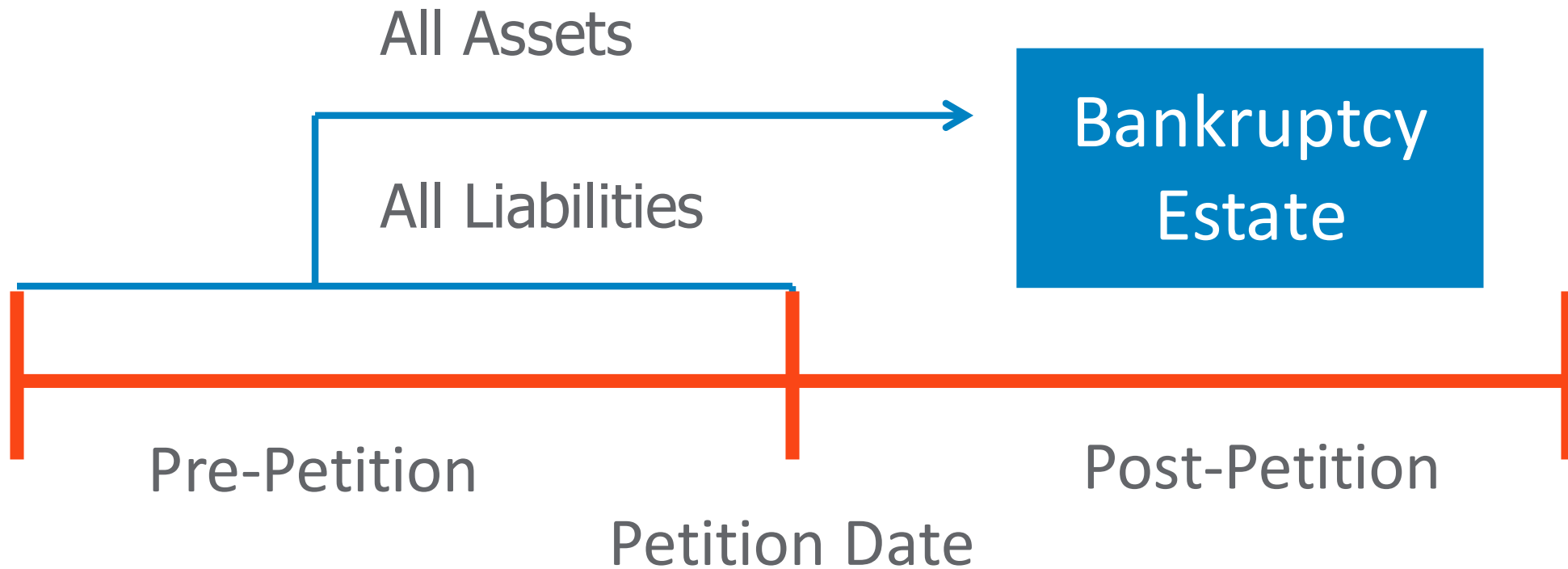
The Bankruptcy Basics

Timeline

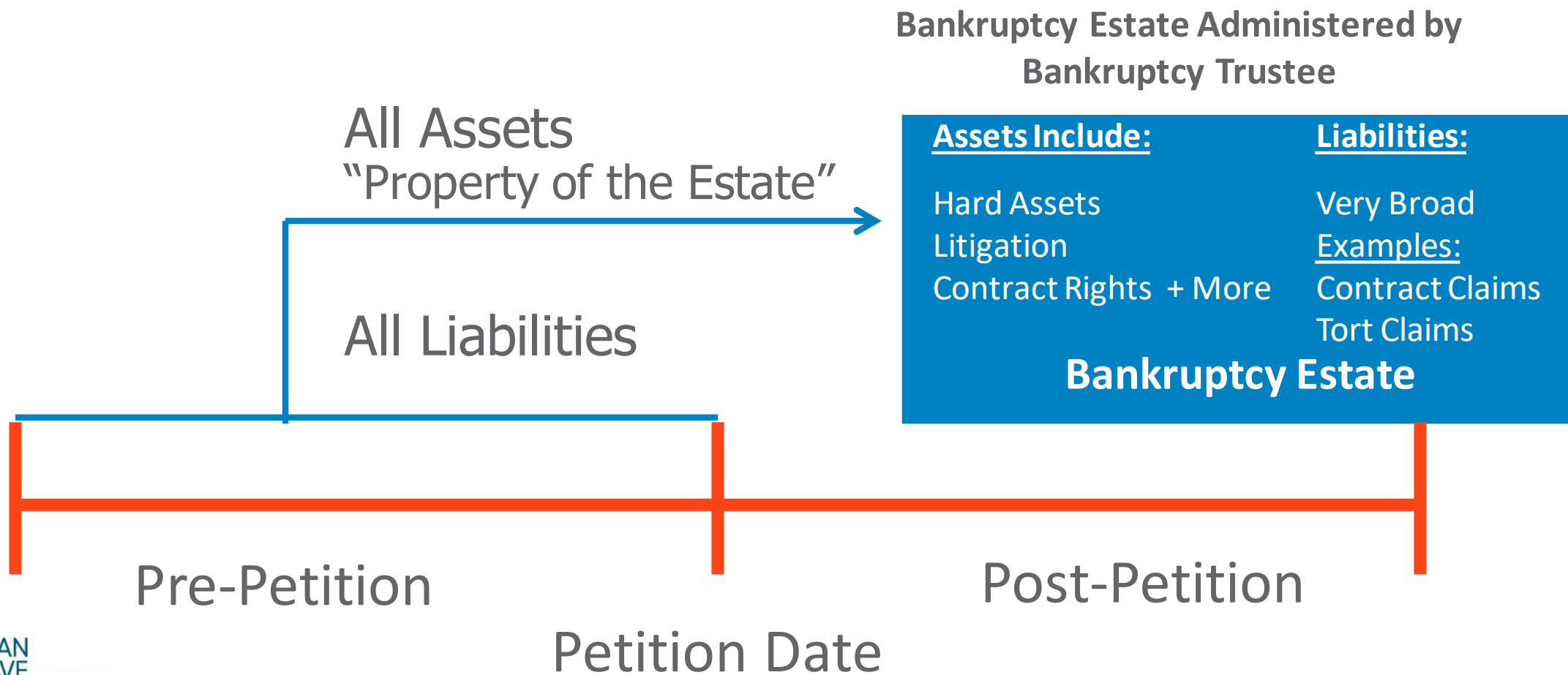


Petition Date

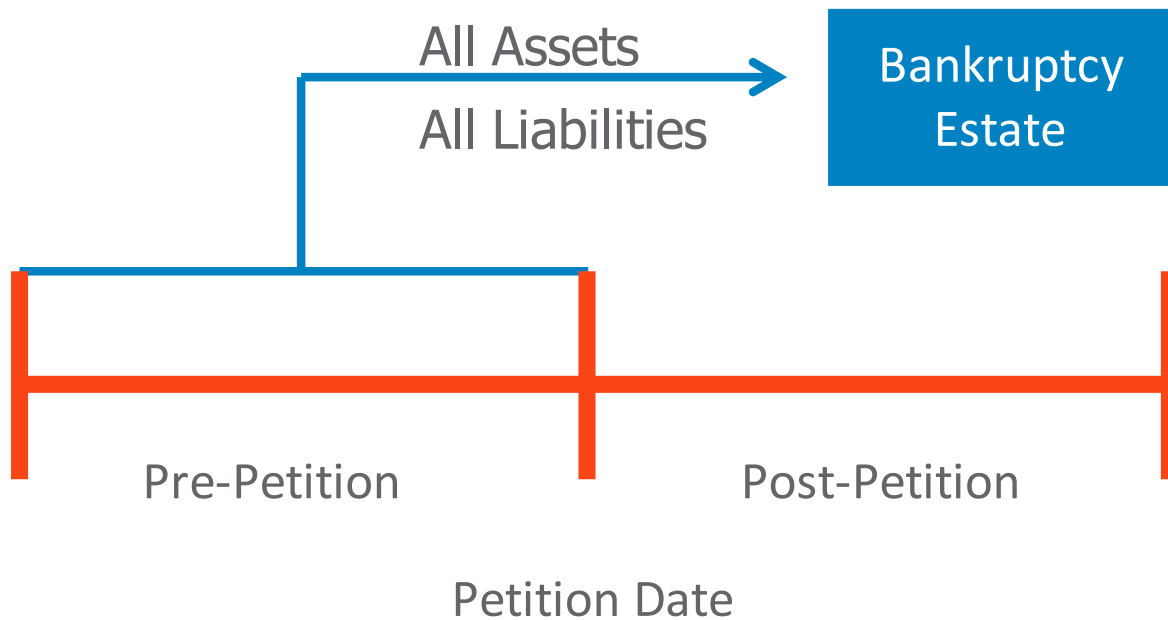
The Bankruptcy Basics



The Bankruptcy Basics



How Do We Get Paid?



Priorities

Secured Claims

- Value of Collateral Balance = Unsecured

Administrative Claims

- Money necessary to operate the business (includes professional fees)
- Trade debt incurred [post-petition]

Priority Unsecured Claims

- Limited Pre-Petition claims (e.g. certain taxes, child support, etc.)

General Unsecured Claims

- Pre-Petition claims

Equity

- Ownership interest

The Automatic Stay – 11 U.S.C. § 362

Assets Include:

Hard Assets
Litigation
Contract Rights + More

Liabilities:

Very Broad
Examples:
Contract Claims
Tort Claims

Bankruptcy Estate

- Automatic Stay is a preliminary injunction that prohibits actions against the debtor or property of the estate
- Effective on the petition date
- Actions taken in violation of the stay are void
- Actions taken in violation of the stay may be subject to sanctions
- Knowledge of the bankruptcy case = knowledge of the stay
- In order to collect against the debtor or property of the estate, you must get relief from stay from the bankruptcy court. Requires specific showings
- Abandoned Assets

Discharge Injunction

- Automatic Stay: injunction during the bankruptcy case
- Discharge: final and permanent injunction at the end of the bankruptcy case
 - Misconception that litigation can resume when bankruptcy case ends

How Do We Get Paid?

Protecting your rights

- File a claim!
- Different claim = different priority
- Pay attention to the pleadings!

Priorities

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Litigation & Bankruptcy

- Using bankruptcy courts for non-bankruptcy matters
- Using bankruptcy as leverage
- Avoiding preference actions

Traps for the Unwary for Transactional Attorneys

- Drafting Considerations
- Distressed Sales of Assets

How to Get the Benefit of the Bargain

- Why do transactional lawyers care about the bankruptcy case?
 - May be required to provide goods & services post-petition even though you are owed \$ pre-petition
 - Your executory contract may be assigned to another entity over your objection & over the contract terms
 - Remedies for default will change
 - Default and termination

Enforcement of Ipso Facto Clauses?

11 U.S.C. § 365(e)(1)

- What are ipso facto clauses?
- Purport to allow party to avoid contractual relationship with financially unstable counterparty
- Generally not enforced in bankruptcy
- If enforced, debtor could never assume beneficial contracts
- Protect debtors and their creditors

Assumption, Assignment, & Rejection

11 U.S.C. § 365

- Assumption and Assignment
 - Must be an “executory contract” – meaning must be performance due on both sides
 - Requires cure and “adequate assurance of future performance”
- Rejection
 - Rejection = Breach of Contract
 - Effect = Unsecured Claim usually as of Petition Date

Examples

- Classic Example – Commercial Real Estate Leases
- Supply Contracts
- IP Contracts/Licenses
 - Special rules for non-exclusive IP contracts
 - Requires licensor's consent

- Important Practice Points: The rejection or assumption and assignment of executory contracts are typically dealt with in a sale or plan
 - Watch for these pleadings!
 - Could affect rights if you do not take action
 - Usually specific pleadings that set forth protocol

Distressed Sales – 11 U.S.C. § 363 Benefits

- Robust protection for post-petition ordinary course of business
- Board and management remain in control
- Assets transferred free and clear of liens and encumbrances
- Sale cuts off fraudulent conveyance & (with some exceptions) successor liability risks
- Ability to assume, assign or reject contracts (even contracts that would otherwise be non-assignable or terminable)
- Certain claims capped at statutory maximum
- Potential debtor release
- Stockholder approval not required

Distressed Sales – 11 U.S.C. § 363 Burdens

- Time consuming (risk of business deterioration)
- Expensive
- Little recourse against debtor (limited reps and warranties; no indemnification)
- Diligence important
- Buyer walkaway rights are limited
- Subject to bankruptcy court approval
- Risks of being overbid at an auction

Examples

- Radio Shack
- Golfsmith
- FTD/Personal Creations
- Renovate America, Inc./Personal Energy Finance, Inc.

Slow Paying Clients

- Avoidance Actions

 - Preferences

 - See handout on Tips to Avoid Preference Exposure

 - Fraudulent Conveyances

- Settlement

 - Enforcement of Pre-Petition Settlements

Best Practices to Avoid Preference Liability – Keep Records

- Keep clear records of invoices & payments going back at least 3 years. These records should include:
 - Date that goods or services were provided;
 - General description of the goods or services;
 - Name of the entity that received goods or services;
 - Amount due from the client;
 - Date payment became due;
 - Any attempts made to collect payment;
 - Date payment was received; and
 - Source of payments, including the name of the payer.
- If you become aware that a client has filed for bankruptcy, make sure these records are retained and accessible. They may help you defend yourself against a potential avoidance action.

Best Practices to Avoid Preference Liability – Know Your Client

- When the payer of a bill is not the client, those payments may be subject to avoidance litigation in the event of a bankruptcy. This can be a concern, for example, if the client uses a centralized cash management system in which its bills are routinely paid from an account owned by an affiliated entity.
- Be aware of who is paying a client's bills. If payments are routinely paid by another entity, ensure that the payer has entered into a legally binding agreement to make those payments.

Best Practices to Avoid Preference Liability – Recognize Signs of Trouble

- When a client begins to making payments in a manner that differs from past practices (*i.e.* payments are made later than usual, or sporadic payments are made for groups of invoices) there is an increased risk that such payments may be subject to an avoidance action in the event of bankruptcy.
- To avoid this issue, make efforts to ensure that all bills are paid on time. If invoices are not timely paid, try to avoid taking any unusual measures to collect payment of those invoices. If you have a written, generally applicable protocol for the collection of overdue invoices, ensure that it is complied with.
- If a client begins paying invoices later or more sporadically, consider requesting prepaying or cash on delivery before providing new goods or services to the client.

Serving on a Committee

- Ability to have an influence in the bankruptcy case at the expense of the estate
- Fiduciary duty to all creditors
- Process

Non-Bankruptcy Alternatives

- Assignment for the benefit of creditors (“ABC”)
- Motion for the Appointment of a Receiver
 - State or Federal

Best Practices

- Knowledge is power - Make sure you know about the bankruptcy case
 - In larger cases, usually a dedicated web page with important deadlines and pleadings
 - Calendar the deadlines
- Preserve Administrative Claims - Confirm on a regular basis post-petition payments
- Preserve Unsecured Claims - File a proof of claim by the deadline

Best Practices

- Executory Contracts - Make sure to have all contracts and amendments. Executed versions preferred
- Executory Contracts - Evaluate the debtor's ultimate goal and whether your product is mission critical or may be rejected
- Do not violate the automatic stay!
 - Set alerts
 - If violation of the stay, deal with it quickly (probably through counsel)

Best Practices

- Plan/Sale – figure out appropriate business parameters before starting negotiations
- Plan/Sale – specifically watch for pleadings that reject executory contracts or that seek to assume and assign
 - Will likely be a separate pleading to set the cure amount
- Plan/Sale – watch for deadlines to obtain evidence of “adequate assurance of future performance.” Most times you have to ask for it

Questions?



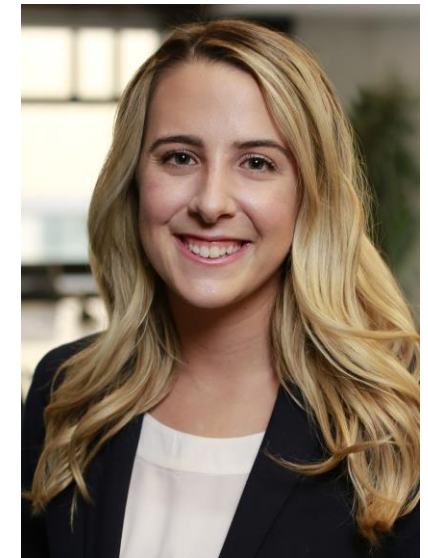
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