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Bankruptcy and Creditors' Rights





Margaret Hackbarth

Assistant General Counsel, Real Estate
margaret.hackbarth@constellation.com



Mark Moedritzer

Partner
mmoedritzer@shb.com



Mike Zito

Partner
mzito@shb.com





Roadmap

- 1 | Trends and Overview
- 2 | Collections and Tactics
- 3 | Bankruptcy Terms and Concepts
- 4 | Areas of Focus
- 5 | Strategic Considerations

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Trends and Overview



March 19, 2023

UBS to buy Credit Suisse for nearly \$3.25B to calm turmoil

“Banking giant UBS is buying troubled rival Credit Suisse for almost \$3.25 billion, in a deal orchestrated by regulators in an effort to avoid further market-shaking turmoil in the global banking system.

The New York Times

March 14, 2023

Meta to Lay Off Another 10,000 Workers

“It would be the tech company’s second round of cuts since November. Mark Zuckerberg, its chief executive, has declare 2023 the “year of efficiency”

March 13, 2023

Collapse of Silicon Valley Bank, Signature Bank Calls Fed Interest Rate Path Into Question

“Banking crisis could put Fed officials in uncomfortable position on next steps in inflation fight.”

Forbes

March 22, 2023

Will The Silicon Valley Bank Fallout Collapse the Housing Market?

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Collections and Tactics

Pre-Litigation

Demand Letters and Emails

- Tailored for businesses
- Professional
- Delivery methods
(mail, fax, email and overnight mail)
- If the first letter is ignored, we send a final demand letter
- Blue Ink and Electronic Signatures
- Deadlines and follow-ups

SHOOK
HARDY & BACON

June 2, 2023

Michael A. Zito

Tom Jones
ACME Corporation
9000 Hollywood Boulevard
Los Angeles, CA 32800

1800 K Street NW Suite 1000
Washington, D.C. 20006
d 202.639.5607
f 202.783.4211
mzito@shb.com

Re: ABC Company vs. ACME Corporation

Dear Mr. Jones:

This firm is legal counsel for ABC Company. We have been directed by our client to recover the amount of \$75,946.20 that is currently owed, as well as any additional amounts to become due according to the terms of your agreement.

Please be advised that if we do not receive full payment immediately, we will retain local counsel and pursue legal action. If we file suit, we intend to request that the court of jurisdiction award to ABC Company all legal and equitable damages permitted by law, including but not limited to:

- the amount owed
- pre-judgment interest on the amount owed
- our court costs
- our investigative expenses
- our litigation expenses
- our legal fees
- any other monetary damages permitted by law

This matter requires your urgent attention. You may contact us at (202)639-5607 or via email at MZITO@SHB.COM if you have any questions.

Very truly yours,



By: Michael A. Zito

ATLANTA | BOSTON | CHICAGO | DALLAS | HAMILTON | HOUSTON | KANSAS CITY | LONDON | LOS ANGELES | MIAMI | NEW YORK |
ORANGE COUNTY | PHILADELPHIA | SAN FRANCISCO | SEATTLE | ST. LOUIS | TAMPA | WASHINGTON, D.C.

Pre-Litigation Instruments

Promissory Notes

- Acknowledges debt is owed
- Eliminates the need to address disputes in the future
- Reduces counterclaim risk
- Allows for fast litigation to get judgment
 - Waiver of Trial
 - Confessed Judgment
- Start payments immediately



Pre-Litigation Instruments

Settlement Agreements

- Mutual Release Language
- Future Business Provision
- Confessed Judgment Provision
- Choice of Law and Venue Provision
- Confidentiality Provision



Pre-Litigation Instruments

Confessed Judgments

- Similar to agreed judgments or consent judgments
- Debtor waives the right to a jury trial, allowing the creditor to have a judgment that is either held in abeyance or that can be enforced immediately
- Useful when a debtor wants to pay but has no funds
- Confessed judgment enforcement varies by state or local practice
- Stand-alone document or can be included in a promissory note



Decision to Litigate

- Risk Assessment
- Likelihood of Success – Can we win?
- Viability of Debtor – Can we collect?
 - Other Creditors
 - Impediments
- Potential for Bankruptcy – Heightened Risk Area
- Rehabilitation of Customer
- Counterclaims



Litigation Process

During the course of litigation, the Defendant may do the following:

- Go out of business
- File bankruptcy
- File Articles of Dissolution
- Sell assets
- If we are able to confirm any of these events, we promptly notify the client and make a determination as to whether it makes sense to continue litigating the case.





Post-Judgment Enforcement

- Levy on Accounts or Properties
- Property Execution to Sheriff
- Debtor's Examination
- Asset Search
- Investigative Resources
- Lien on Assets



Liens

- Varies by state – normally covered by statute
- Gives mechanics and contractors a remedy in the event a property owner fails to pay for work completed.
- Specific time limits to file a notice of mechanic's lien and move to enforce lien
- Priority of liens (generally):
 - Prior liens
 - Subcontractor
 - General contractor
 - Manual Labor
 - Materials

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Bankruptcy Terms and Concepts



Recent Significant Bankruptcies

- Revlon
- FTX Trading
- SVB Financial
- David's Bridal
- Cineworld Group
- Virgin Orbit
- Party City



Bankruptcy Laws

- 1898 – Congress passed Bankruptcy Act
- 1978 – Amended and Became known as Bankruptcy Code
- 2005 – Bankruptcy Abuse Prevention and Credit Protection Act



Types of Bankruptcies

- Chapter 7
 - Liquidation
 - Trustee appointed to run company
 - No further business
- Chapter 11
 - Reorganization
 - Debtor stays in control of company and attempts to re-pay its debts
 - Opportunity for further business



Automatic Stay

- Arises automatically at bankruptcy filing
- Prevents commencement or continuation of actions against debtor or its property
- Prevents termination of existing contracts or leases with debtor
- Prevents payment of prepetition debt with certain exceptions



Types of Creditors

- Secured
 - Debt secured by estate asset
 - Arise per contract or judgment
- Priority
 - Derives from Bankruptcy Code
 - Eg. Wages, taxes, 503b(9) claims
 - Priority vis-à-vis unsecureds
- Unsecured
 - No collateral or priority
 - Eg. – trade debt, unsecured loans
 - Many cases get pennies on dollar

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Areas of Focus




Warning Signs of Potential Bankruptcy

- Lack of, or delayed payments
- Request for modification of terms
- Layoffs and furloughs
- Loss of significant business
- Action by banks (restructuring foreclosure, etc.) and lawsuits
- Media reports, public filings



Pre-Bankruptcy Considerations

- Consider requiring security
 - Why – protection in event of bankruptcy
 - Enforceability issues
- Considering requiring prepayment / COD
 - Protects payments from bankruptcy clawback
 - Allows for further business



Chapter 7 Liquidation Basics

- Notice and opportunity to participate
- Stay of collection efforts
- Debtor liquidating, and so few going forward business issues
- Contracts and policies quickly terminated
- Right to file claim for pre-petition debt
- Wait for distribution



Chapter 11 Reorganization Basics

- Notice and opportunity to participate
- Stay of collection efforts and termination of contracts
- Difference: Debtor continues operating, so are going forward business issues



Treatment of Contracts in Chapter 11

- Bankruptcy stays termination of contracts
- “Executory Contracts” (where material obligations remain for both parties) continue until assumed or rejected
- Debtor must assume or reject contracts, but has until late in bankruptcy to do so
- If assumes, contract continues and debtor must fully pay pre and postpetition debt
- Problem - Creditors must perform on executory contracts (i.e., extend credit) pending assumption or rejection
 - Exception – contracts to loan money



Bankruptcy Claim Filing Process

- Types of claims
- Notice of claims bar dates
 - Prepetition
 - Post-petition
- Instructions for preparing claim
- Filing – electronically, by mail, or claims agent
- Claim required in Chapter 7, but not necessarily in 11



Preference Claims

- Action to recover amounts paid by debtor to creditors within 90 days prior to bankruptcy
- Basis – Presumed debtor insolvent in 90 days prior to bankruptcy, and so creditors receiving payments preferred over others
- Impact – May have to return payments received within 90 days of bankruptcy even though provided service
- Rationale – Why do these claims exist
- Timing – When are these claims made



Limitations on Preference Claims

- N/A payments outside 90 days
- Not apply to secured creditors
- Not apply to prepayments/COD
- Not apply where payments less than \$7,575
- Must be filed within two years of bankruptcy
- Claims less than \$27,750 may have to be filed where defendant located



Preference Claim Defenses

- Two primary defenses
 - Ordinary course
 - New value
- Defenses not mutually exclusive – can argue alternatively or in tandem



New Value Defense

- If after receipt of preference payment, creditor extends more services on credit, amount of new credit can reduce liability
- Test is mathematical computation
 - *E.g.*, Jan. 1 - \$5,000 payment received
 - Jan. 20 - \$4,000 more services provided on credit
 - Feb. 15 - bankruptcy filing
 - Potential preference reduced to \$1,000
 - Issue - Does it matter if \$4,000 in new credit extended Jan. 15 is paid before or after bankruptcy?



Ordinary Course Defense

- Payments in ordinary course can be exempt from preference laws
- Test – Subjective / not mathematical
- Two parts
 - Whether 90 day payments consistent with prior history in timing /manner
 - Timing of payments most important and is analysis of days to pay
 - Manner of payments means ways transmitted (e.g., check, wire)
 - Whether collection efforts consistent



Other Preference Claim Strategies

- Resist paying full amount demanded
 - Almost always have some defense
 - Can get 15/20% or more discount even if no defenses
- Be cautious with early settlement
 - Might get “new” more reasonable opponent
 - Might be challenge to insolvency which if successful eliminates claim
 - Might get an “end of case” deal
- Leverage § 502(h) claims



Involuntary Bankruptcies

- Can in certain circumstances force a debtor into bankruptcy
- Why – believe grossly mismanaging company, or diverting money or assets
- Requires at least 3 creditors with unsecured claims totaling \$16,750 or more
- Must prove debtor “Generally not paying debts as come due”
- Risks



Non- Bankruptcy Liquidations

- Assignments for the Benefit of Creditors (ABC's)
- Receiverships
- Corporate Dissolutions under State law
- Close the Doors

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Strategic Considerations



Strategic Considerations

- Litigation or arbitration
- Post-pandemic related conditions
- Strength of contractual terms
- Insolvency risk
- Customer tactics
- Industry specific credit risks
- Creditor marketplace

Questions