

Association of Corporate Counsel - SC
Presentation

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Greenville, South Carolina

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Trouble in Texas

Bankruptcy Judge Resigns Amid Scandal:
A Resurrection of Due Process for Creditors?

Summary of Presentation

1. Chapter 11 creates risk for vendors regarding:
 - a. Payment of pre-Chapter 11 accounts receivable
 - b. Payment for goods or services provided post-Chapter 11 filing
 - c. Possible rejection and breach of any sales or supply contract
2. Creditors have remedies and strategies to minimize risk and improve recoveries
3. Chapter 11 "Hotspots," particularly Texas, created additional risk for creditors by limiting fulsome due process in protecting their rights
4. What follows:
 - Trouble in Texas
 - Vendor Chapter 11 strategies to minimize risk of loss
 - Chapter 11, particularly First Day hearings, impacts those strategies

Trouble in Texas

1. The Fall of Enron
2. The Rise of Texas
 - Texas as a Chapter 11 “hotspot”
 - Former Judge David Jones' role in putting Texas on the Chapter 11 map
 - Houston Chronicle – “the judge who saved the Texas bankruptcy practice”
 - 1st half of 2023 – 16 of the 20 largest Chapter 11's filed in the Southern District of Texas

3. The Rise of Venue and Judge Shopping

- 2021 Senate Judiciary Committee hearings on possible Chapter 11 fraud
- Georgetown Law School Professor Adam Levitin testimony
- Purdue Pharma – Non-consensual Plan Releases – Judge Robert Drain
- Big Law filed all “its” cases in Texas

4. The Rise of Judge Jones

- Jones implemented a complex case assignment procedure
- “I want to go faster”
 - Party City Chapter 11
 - Serta Simmons Chapter 11
- Due Process requirements for notice to creditors

5. The Fall of Judge Jones

- McDermott International Shareholder lawsuit against Jones
- Jackson Walker / Elizabeth Freeman were go-to local counsel for large Chapter 11 cases
- Jones / Freeman relationship not disclosed
- Wall Street Journal provided details of the Jones / Freeman relationship
- 5th Circuit Court of Appeals Chief Judge initiated ethics investigation re Jones

6. The Fall of Texas as a Chapter 11 hotspot?

- Resignation of Judge Jones
- Aftermath:
 - Jackson Walker fee disgorgement
 - Lawsuit against Jones, Freeman, Jackson Walker and Kirkland Ellis
- New Jersey the new “hotspot”?

Key Strategies for Creditors to Minimize Risk and Enhance Recovery

1. Pre-petition Accounts Receivable Balance
 - Critical Vendor
 - Payment of pre-petition debt
 - Trade Agreement as a condition of payment
 - Bankruptcy Court caps the funds available to pay critical vendors

- Creditors should immediately engage with the Debtor to maximize their share of funds
- Important to consider the potential Section 362 Automatic Stay violations for refusal to ship goods
- Bankruptcy Code Section 503(b)(9) Administrative Priority Claim
 - Shifts of portion of pre-petition unsecured debt to post-petition administrative expense priority claim
 - Section 503(b)(9) as a replacement for reclamation?

2. Payment of Post-petition extensions of credit
 - Impact of DIP (debtor-in-possession) financing
 - Credit risk analysis includes impact of DIP financing
 - Analyze DIP budget for adequate liquidity to pay vendors
 - UCC 2-609: consider a demand adequate assurances of future performance

- Administrative Insolvency
 - Debtor enterprise value and/or liquidity insufficient to pay post-petition administrative claims
 - Administrative claims include post-petition sales and Section 503(b)(9) claims
 - Administrative claims are junior to secured claims
- Section 363 sales
 - Asset Purchase Agreements always exclude pre-closing date liabilities

3. Chapter 11 Impact on sales or supply agreements
 - Debtor's right to assume or reject contracts
 - Debtor's right to assume and assign contracts to third-party buyers
 - Debtor required to "cure" (pay) arrearages

4. Setoff and Recoupment Remedies

- Rebates
- Sales incentives
- Pre-petition exercise of setoff
- Post-petition exercise of setoff – motion for relief from stay
- “Triangular” setoffs

Chapter 11 First Day Hearings Can Impact These Rights

1. Chapter 11 First Day Hearing
 - Within 24-48 hours of Chapter 11 filing
 - DIP financing
 - Prepackaged Plan
 - Section 363 sale teed up
 - “I want to go faster”

2. First Day Automatic Stay Violation Orders
 - Dean Foods
 - Section 365 executory contracts – prohibition on termination or modification of contracts
 - Credit terms may be risky
3. DIP Financing “Super-priority” Administrative Claim in favor of Lender

4. Section 363 APAs

- Buyers purchase “rights to payments from third parties” (deposit or setoff claims)
- Buyers exclude all liabilities
- After Section 363 sale, debtor “owns” liabilities to creditors; buyer owns monies due from creditors
- Destroys “mutuality” required for setoff or recoupment

5. Plans of Reorganization

- Pre-packaged or restructuring plan
- Broad non-consensual release of third-parties, and relating to debtors' contract obligations
- Waiver of set-off claims

Thank you for your attendance.

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As capital markets, the global economy, and industries evolve and change, corporate insolvencies play an increasingly significant role in today's business environment. Companies utilize the special provisions of bankruptcy law to buy and sell distressed assets, shed unwanted contractual obligations, restructure balance sheets, resolve legacy obligations, and achieve reductions in workforce. Shumaker helps various stakeholders in business insolvencies to protect and maximize the value of their interests. Clients tell us we add value by getting it right. We devise creative, strategic solutions that meet our clients' goals, both nationwide—including representation in bankruptcy courts in 36 states—and around the globe. Clients involved in a business insolvency need decisive, spot-on advice to maximize outcomes in insolvency situations. Recognizing that there is little margin for error in business insolvencies, we proactively use our experience and command of applicable law to our clients' advantage.

U.S. Nationwide Insolvency Practice

- Lawyers in our Bankruptcy group have handled numerous cases as lead counsel in bankruptcy cases throughout the U.S., including in Delaware, the Southern District of New York, and the Southern District of Texas. The U.S. Bankruptcy Code is federal law and is applied substantially uniformly in all U.S. states.
- Delaware is a unique jurisdiction. Its status as a popular state of incorporation results in many Chapter 11 filings there, even though the Chapter 11 debtors are headquartered elsewhere. Due to Bankruptcy Code venue rules, many cases are also filed in the Southern District of New York and the Southern District of Texas. Many professionals who are involved in Chapter 11 cases in these districts are not licensed or located in the districts. The Bankruptcy Courts routinely allow outside professionals to participate in Chapter 11 matters.
- Shumaker has represented numerous creditors' committees as well as individual creditors and stakeholders regarding their particular legal issues. These include suppliers, customers, counter-parties to contracts, financial institutions, purchasers of assets, and distressed companies.

Global Insolvency Practice

- Shumaker handles inbound insolvency matters for foreign-based companies or their administrators, including informal restructurings, formal Chapter 11 or Chapter 15 filings, sales of assets, and litigation related to a U.S. presence or business activities. We also represent U.S.-based entities regarding insolvencies in foreign jurisdictions and partner with our global network of professional colleagues for outbound insolvency matters

OUR CLIENTS

- Creditors' committees
- Suppliers to or customers of distressed companies
- Financial institutions and lenders (both secured and unsecured)
- Distressed companies, including boards of directors, private equity, and portfolio companies
- Foreign debtors or administrators in cross-border insolvency cases
- Trustees in bankruptcy
- Receivers for distressed assets
- Counter-parties to contracts with distressed companies
- Buyers of distressed assets
- Landlords and tenants

OUR SERVICES

- Official creditors' committee representation
- Unsecured creditors' rights and remedies
- Secured lender rights and remedies
- Bankruptcy or workout planning
- Fiduciary duties of officers and directors
- Chapter 11 filings
- Chapter 7 liquidations
- Cross-border insolvencies, including Chapter 15
- Post-petition financing
- First-day motions
- Receiverships
- Assignments for the benefit of creditors
- Non-bankruptcy workouts and forbearance agreements
- Avoidance litigation
- Preference defense
- Equitable subordination claims
- Lender liability claims
- Section 363 sales
- Forensic analysis
- Intellectual property rights in bankruptcy
- Labor and employment rights for insolvent companies
- Collective bargaining and retiree obligations
- Tax issues arising from distressed companies

REPRESENTATIVE CHAPTER 11 OR INSOLVENCY MATTERS

- Allens, Inc. (Arkansas)
- American Apparel Company (South Carolina)
- Appvion, Inc. (Delaware)
- Armstrong Flooring, Inc. (Delaware)
- Bernard Madoff Investment Securities, LLC (New York)
- Blue Water Automotive, Inc. (Detroit)
- Borden Dairy Company (Delaware)
- Burlington Industries, Inc. (Delaware)
- Central Grocers, Inc. (Delaware)
- Collins & Aikman Inc. (Michigan)
- DB Holdings Liquidation, Inc. (Delaware)
- Dana Automotive, Inc. (New York)
- Dean Foods Company (Texas)
- Eastman Kodak Company (New York)
- Fairfield Sentry Limited (New York)
- Federated Department Stores, Inc. (Ohio)
- Fruit of the Loom, Inc. (Delaware)
- GT Advanced Technologies, Inc. (New Hampshire)
- General Motors (New York)
- Heritage Home Group, LLC (Delaware)
- Hertz Corporation (Delaware)
- Hexion Holdings (Delaware)
- hhgregg, Inc. (Indiana)
- Imerys Talc America (Delaware)
- J.A. Jones Construction (Charlotte)
- Jos. A. Bank Clothiers, Inc. (Tailored Brands, Inc.) (Texas)
- Kmart Corporation (Illinois)
- LSC Communications, Inc. (New York)
- Levitz Furniture Incorporated (Delaware)
- Logo Athletics, Inc. (Delaware)
- MF Global Inc. (New York)
- McDermott International, Inc. (Chicago Bridge & Iron Company) (Texas)
- Montgomery Ward (Delaware)
- NORPAC Foods, Inc. (Oregon)
- Neiman Marcus Group Ltd LLC (Texas)
- PTL Heritage USA (South Carolina)
- Pillowtex, Inc. (Delaware)
- Polaroid Corporation (Delaware)
- Quebecor, Inc. (New York)
- Remington Outdoor Company, Inc. (Delaware)
- Revlon, Inc. (New York)
- Rite Aid Corporation (New Jersey)
- Sears Holdings Corporation (New York)
- SemCrude, L.P. (Delaware)
- Smurfit-Stone Container Corporation (Delaware)
- Southern Grocers, LLC (BiLo/Winn-Dixie) (Delaware)
- Sports Authority Holdings, Inc. (Delaware)
- TK Holdings Inc. (Takata) (Delaware)
- The Bon-Ton Stores, Inc. (Delaware)
- Toys “R” Us, Inc. (Virginia)
- United Industries Corporation/Spectrum Brands, Inc. (Texas)
- Vital Pharmaceuticals, Inc. (dba Bang Energy/Quash Seltzer) (Florida)
- Visteon Corporation (Delaware)
- Willowood USA Holdings, LLC (Colorado)
- Z Gallerie, LLC (Delaware)

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THE FALL OF ENRON

Texas is the 2nd largest U.S. state (after Alaska). It is an economic engine in the U.S. fueled primarily by the oil and gas industry. When Houston-based Enron Corporation filed its Chapter 11 case in the Southern District of New York in 2001, Texans were mad. Enron was the largest U.S. Chapter 11 case at the time. It also sparked one of the largest corporate scandals in U.S. history.

THE RISE OF TEXAS

In late 2020, the *Houston Chronicle* featured Judge Jones as “the judge who saved the Texas bankruptcy practice,” heralding a dramatic shift of filings of complex Chapter 11 cases from Delaware and New York to Texas. Since Enron, the Texas Bankruptcy Court, specifically the Southern District of Texas in Houston, became one of the Chapter 11 “hotspots,” challenging the supremacy of Delaware and the Southern District of New York. In the 1st half of 2023, 16 of the 20 largest Chapter 11 cases were filed in the Southern District of Texas. This trend is similar in prior years, as the Southern District of Texas became the “go-to” venue for large Chapter 11 cases.

THE RISE OF VENUE AND JUDGE SHOPPING

In 2021, a U.S. Senate Judiciary Committee conducted hearings on possible fraud in Chapter 11 cases, including testimony from Georgetown Law School Professor, Adam Levitin. The essence of Levitin’s testimony was that “Big Law” handpicked not only the venue, but the particular judge for filing cases. The Purdue Pharma Chapter 11 case was specifically filed in the Southern District of New York, White Plains Division. Only Judge Robert Drain handled cases filed in the White Plains Division. He had a reputation for approving Chapter 11 plans that contained broad non-consensual releases of non-debtors. The Purdue Pharma Chapter 11 Plan releases were approved by Judge Drain, but are now on appeal before the U.S. Supreme Court, with oral arguments having occurred on December 6 and 7, 2023. Since the Senate hearings, the New York Bankruptcy Court has made all case assignments random.

Levitin also noted that a “Big Law” law firm ran into trouble in Delaware when a judge was “furious” regarding the terms of DIP financing proposed by Big Law, and also denied portions of the law firm’s fee application. According to Levitin, Big Law “took its business” to other judicial districts, particularly the Southern District of Texas, where large Chapter 11 filings surged.

THE RISE OF JUDGE JONES

Judge Jones was instrumental in restructuring the Texas Bankruptcy Court, that facilitated the Chapter 11 filing surge by implementing a case assignment procedure where all “complex” Chapter 11 cases were automatically assigned to two judges: Judge Jones or Judge Marvin Isgur. Thus, companies, and their counsel, knew with certainty the identity of their judge if they filed Chapter 11 in the Southern District of Texas. By contrast, Delaware’s case assignment procedure is random.

As national Chapter 11 counsel for creditors, we have appeared in dozens of Chapter 11 cases before Judges Jones and Isgur. Within a period of a week, Judge Jones presided over 1st day hearings for two cases in particular: Party City (January 18, 2023) and Serta Simmons (January 24, 2023). In both cases, in connection with the Debtors’ motions for DIP financing, Judge Jones’ statement was, “I see you are going very fast ... I want to go faster.” He offered final approval of the DIP financing, when only interim approval was requested by the Debtors. Pursuant to the Bankruptcy Rules and customary practice, for final approval of DIP financing, bankruptcy courts require not less than 14 and up to 30 days’ notice to creditors.

THE FALL OF JUDGE JONES

On October 4, 2023, a lawsuit filed by a *pro se* litigant and former shareholder of energy and construction company McDermott International, which had gone through a Chapter 11 restructuring approved by Judge Jones in 2020, accused Judge Jones of failing to disclose his relationship with a partner at Jackson Walker LLP.

The law firm of Jackson Walker LLP was frequently selected as local counsel by “Big Law” for their Chapter 11 cases in Texas. A Jackson Walker partner Elizabeth Freeman has been in a romantic relationship with Jones, and they were living together. Simultaneously, Jackson Walker and Freeman specifically were working on many cases over which Judge Jones presided. Many details of the Jones-Freeman relationship have been publicly reported in press including *Wall Street Journal* articles. Jones initially denied any wrongdoing and asserted that he had no duty to recuse himself from presiding over these cases because they were not married (they were “co-habiting”), and they did not commingle funds. However, the *Wall Street Journal* subsequently reported Jones and Freeman co-owned a home, and had a joint bank account. Additionally, neither Freeman nor Jackson Walker disclosed potential conflicts required by the Bankruptcy Code in connection with applications to be retained and be paid by the Debtors.

Despite Jones’ denials, after the *Wall Street Journal* and other media reports of alleged facts, the Chief Judge of the U.S. Court of Appeals for the 5th Circuit filed a formal ethics probe into Jones’ failure to disclose the romantic relationship. Initially, Judge Jones did not resign, but all his cases were re-assigned to other Texas bankruptcy judges. Shortly after the initiation of the formal ethics probe, Jones resigned from the Bankruptcy Court altogether.

The potential impact and fallout from the scandal is yet to be determined. To date, the United States Trustee has sought to disgorge fees from Jackson Walker of at least \$13 million. Also, any orders and rulings by Judge Jones where recusal should have occurred are potentially subject to being set aside. It remains to be seen whether further investigations will occur regarding Judge Jones, Freeman, Jackson Walker and Big Law.

Also, Texas Bankruptcy Court has come under pressure to modify its case assignment procedure to become random as in Delaware and New York.

THE FALL OF TEXAS?

Since Judge Jones’ resignation, several large Chapter 11 cases have been filed in the Bankruptcy Court for the District of New Jersey, such as Rite Aid and WeWork, prompting speculation that New Jersey will become the new “hotspot.” New Jersey is also the venue for home goods retailer Bed Bath & Beyond’s Chapter 11 case as well as Johnson & Johnson subsidiary LTL Management’s second attempt to resolve its mass talc liabilities via bankruptcy. As one sanguine New York attorney noted, New Jersey and Delaware are much closer than Texas.

As a result of the Jones fallout, will companies switch to Delaware, New York, or New Jersey as restructuring venues? 2024 will be an interesting year.

It is common for foreign-based companies to file Chapter 11 in the U.S. to implement restructuring objectives. Such companies and their counsel essentially have had their choice of forum and judges for the Chapter 11 filings. Scandinavian Airlines is a recent example, where the Swedish-based company filed Chapter 11 in the Southern District of New York to implement its restructuring. Houston-based energy and construction giant McDermott International filed Chapter 11 in Houston in 2020. In September, 2023, McDermott announced that it entered into a transaction support agreement (TSA) for a financial restructuring and commenced a Dutch Wet Homologatie Onderhands Akkoord (WHOA) proceeding and a UK restructuring plan (RP) under Part 26A of the UK Companies Act 2006 (CA 2006). On October 9, 2023, McDermott filed an ancillary Chapter 15 proceeding in Houston, primarily for the purpose of U.S. approval and enforcement of the Dutch and English restructuring plans in the U.S.

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DAVID H. CONAWAY
BIOGRAPHY

- David's focus is representing manufacturing companies regarding a variety of issues involving customers and the supply chain, including commercial and financial contracts, disputes, insolvency; and cross-border transactions, litigation and insolvency.
- He advises clients and handles matters throughout the U.S. and abroad, and represents numerous foreign-based clients regarding U.S. issues, and U.S. companies doing business globally.
- Industry experience includes agrichemicals and seeds, appliances, chemicals, plastics and resins, furniture, paper and packaging, forest products, steel and metals, aluminum and glass containers and packaging, food packaging, textiles, and machinery and equipment.
- David is the Chair of Shumaker's Bankruptcy, Insolvency and Creditors' Rights Practice and of Shumaker's Global and Cross-Border Insolvency Practice; the Co-Chair of Shumaker Manufacturing; and a past member of Shumaker's Executive Committee, and Managing Partner of the firm's Charlotte office.
- David is the Chairman of Global Advocaten, a Chambers ranked leading global legal network in 28 countries, on 4 continents, with 1400+ lawyers speaking 31 languages. GlobalAdvocaten.com
- Representative Cases:

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Bernard Madoff Investment Securities,
LLC (New York)
Borden Dairy Company (Delaware)
Dean Foods Company (Texas)
Fruit of the Loom, Inc. (Delaware)
General Motors (New York)
Hertz Corporation (Delaware)
Instant Brands (InstaPot, Pyrex) (Texas)
Jos. A. Bank Clothiers, Inc. (Tailored
Brands, Inc.) (Texas)
Kmart Corporation (Illinois)
McDermott International, Inc. (Chicago
Bridge & Iron Company) (Texas)
MF Global Inc. (New York)

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Party City Holdco Inc. (Texas)
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Southern Grocers, LLC (BiLo/Winn-Dixie)
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