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Strategies of Lenders, Landlords and Logistic Companies Dealing with Chapter 11 Bankruptcies

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CH. 11 BANKRUPTCY SEMINAR

STRATEGIES OF LENDERS, LANDLORDS & LOGISTICS COMPANIES

Maintaining Triple Threat Position:

Push, Posture & Maximize Value

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Chapter 11 – The Basics

- In a Chapter 11, a debtor in possession retains its assets and seeks to reorganize its debts or maximize value of assets through a going-concern sale.

- Ultimately, the debtor wants to propose a feasible, consensual repayment plan to address its debts and have such plan approved by the Bankruptcy Court.

- In Chapter 11, the debtor receives a discharge of its debts upon having its bankruptcy plan confirmed by the Court.

The Bankruptcy Waterfall

- Secured Creditors
  (mortgage lender, perfected lien claimants – limited to collateral)

  (order flips in Chapter 11 Plans)
- Administrative Claimants
  (Professional fees & creditors providing post-bankruptcy goods and services benefitting the estate)
- Other Priority Claimants
  (certain tax claims, employee-related claims and customer deposits)
- General Unsecured Creditors (GUCs)
  (Unperfected/under-secured lien creditors and most other trade creditors including many claims of landlords and logistics companies)
- Equity
  (Property owners, company owners & shareholders. Usually filing to attempt to restructure debt, preserve equity in the property or to minimize guarantee exposure. Limitations on ability to retain equity in Chapter 11)

The Three Phases of a Chapter 11 Case

	Debtor	Creditor
• Phase One:	Stabilize	Push
• Phase Two:	Attack	Posture
• Phase Three:	Emerge	Maximize Value

** In Chapter 7, debtor is largely out of the picture and Trustee is administering assets at liquidation value. Generally, less strategy and negotiation, more litigation.

Phase One

- Debtor’s Goal: Survive

  (stabilize operations, seek use of cash collateral, negotiate with critical vendors and logistics companies)

- Lender’s Response: Push
  - Motion to Dismiss/Convert
  - Stay Relief
  - Oppose Use of Cash Collateral
  - Sue Guarantors, pursue non-estate property

Phase One (Debtor Survival)

- Debtor Survival

  - Imposition of Automatic Stay (breathing spell)
  - Pare Down Operations/Management
  - Budget/Cash Collateral
  - Satisfy Administrative Functions of Ch.11

Phase One (Lender Push)

- Lender's Response:

  - Motion to Dismiss (bad faith filing, SPEs)

  - Stay Relief (Single Asset Real Estate)

  - Oppose Use of Cash Collateral

    (adequate protection/budget)

  - Sue Guarantors, pursue existing deposits and LOC, push for improved treatment.

    (note: Otero Mills injunction)

Motion to Dismiss (Bad Faith Filing)

- Bad Faith Filing Factors:
  - (i) Only One Asset;
  - (ii) Few unsecured debts in relation to amount of secured debts;
  - (iii) Few employees;
  - (iv) Property subject of foreclosure action as a result of arrearages on debt;
  - (v) Debtor’s financial problems are essentially result of two party fight with secured creditor that can be resolved in pending state court action; &
  - (vi) Timing of debtor’s filing evidences an intent to delay or frustrate the legitimate efforts of secured creditors to enforce their rights.
- *In re Phoenix Piccadilly, Ltd.*, 849 F.2d 1393 (11th Cir. 1988)
- **Current Trend: not granting dismissal, but affording stay relief through judgment but come back to bankruptcy court prior to foreclosure sale.**

Motion to Dismiss (SPEs)

- Single Purpose Entities:
  - "bankruptcy remote" vehicles.
  - created to fulfill narrow, specific or temporary objectives.
  - typically used by companies to isolate firm from financial risk.
  - Many times are holding companies for real estate

** issues of corp authority and solvency

SPEs – General Growth Properties 409 B.R. 43 (Bankr.S.D.N.Y. 2009)

- GGP – then largest real estate bankruptcy case ever – over $27 billion in debt.
- GGP and over 160 shopping center subs filed for Chapter 11.
- Many of the subs were formed as bankruptcy-remote SPEs and had financed their properties with commercial mortgage-backed securities (CMBS).
- The CMBS loans mostly were not in default, were solvent entities with excess cash flow and continued to be adequately collateralized.
- MTD denied as court considered corporate group as a whole not solvency of each unit.

Motion for Stay Relief

- Creditors can obtain relief from the automatic breathing spell afforded debtors for “cause” which is an undefined term in the Code.
- “Cause” can include lack of adequate protection, lack of equity or the subject property not being necessary to an effective reorganization.
- Usually, assets with equity provide a satisfactory form of adequate protection. In the absence of a comfortable equity cushion, stay relief is normally eschewed in favor of adequate protection payments built in to a negotiated budget.
- Hopelessly under-secured creditors should file for and receive stay relief absent adequate protection terms acceptable to them.

Motion for Stay Relief - SAREs

- *What is considered Single Asset Real Estate*
- *Limited Automatic Stay Period*
- *Extensions*
- *Plan Filing Standards for SARE Purposes*
- *“Checking the Box”*

Motion for Stay Relief - SAREs

- Courts disagree as to the analysis of determining a SARE case.

- While there are cases all over the place evaluating the amount, kind and extent of business being run and operated by a particular debtor, a good general rule of thumb is that a SARE would involve an entity whose revenues received by the owner are almost entirely **PASSIVE** in nature as a result of the real estate holding and not derived from an active business.

- As an example, revenues derived solely from rentals would probably qualify as SARE, where revenue from operating a timber business on 200 acres of land would not since it involves a substantial business other than the operation of the real estate.

- Sophisticated operators of real estate have posited opening up a gift shop, breakfast shop or other minor “business” on the premises to try and keep themselves out of the more harsh stay relief provisions for SARE cases.

Is the Debtor a SARE?

101(51B) – think commercial real estate passive holding

S.A.R.E. - Limited Automatic Stay

- *90-day automatic stay period for single asset real estate (SARE) cases (§362(d)(3)).*

- *File plan or make debt service payments later of 90 days or 30 days after determination of being a SARE Debtor.*

- Debt service usually comprised of interest payments equal to the non-default contract interest rate on the value of the creditor's interest in the real estate.

S.A.R.E. – Extension and "Checking the Box"

- *Extension issue – "for cause" and only one continuance.*

- *Satisfying Plan Filing Standard – reasonable possibility of being confirmed.*

- *"Checking the Box" issues.*

Motion for Stay Relief - SAREs

- A debtor can designate itself a SARE debtor on the bankruptcy petition.

- If the debtor does not identify itself as a SARE debtor when the case is filed, the secured lender can bring a motion with the court asking that the debtor be classified as a SARE debtor for purposes of imposing the special stay relief requirements.

** SARE debtor cannot be a SBRA Debtor including under CARES Act.

6. Type of debtor

- ☐ Corporation (including Limited Liability Company (LLC) and Limited Liability Partnership (LLP))
- ☐ Partnership (excluding LLP)
- ☐ Other. Specify: ____

7. Describe debtor's business

A. *Check one:*

- ☐ Health Care Business (as defined in 11 U.S.C. § 101(27A))
- ☐ Single Asset Real Estate (as defined in 11 U.S.C. § 101(51B))
- ☐ Railroad (as defined in 11 U.S.C. § 101(44))
- ☐ Stockbroker (as defined in 11 U.S.C. § 101(53A))
- ☐ Commodity Broker (as defined in 11 U.S.C. § 101(6))
- ☐ Clearing Bank (as defined in 11 U.S.C. § 781(3))
- ☐ None of the above

B. *Check all that apply:*

- ☐ Tax-exempt entity (as described in 26 U.S.C. § 501)
- ☐ Investment company, including hedge fund or pooled investment vehicle (as defined in 15 U.S.C. § 80a-3)
- ☐ Investment advisor (as defined in 15 U.S.C. § 80b-2(a)(11))

C. NAICS (North American Industry Classification System) 4-digit code that best describes debtor. See http://www.uscourts.gov/four-digit-national-association-naics-codes .

___ ___ ___ ___

8. Under which chapter of the Bankruptcy Code is the debtor filing?

A debtor who is a "small business debtor" must check the first sub-box. A debtor as defined in § 1182(1) who elects to proceed under subchapter V of chapter 11 (whether or not the debtor is a "small business debtor") must check the second sub-box.

Check one:

- ☐ Chapter 7
- ☐ Chapter 9
- ☐ Chapter 11. *Check all that apply:*
  - ☐ The debtor is a small business debtor as defined in 11 U.S.C. § 101(51D), and its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $2,725,625. If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).
  - ☐ The debtor is a debtor as defined in 11 U.S.C. § 1182(1), its aggregate noncontingent liquidated debts (excluding debts owed to insiders or affiliates) are less than $7,500,000, **and it chooses to proceed under Subchapter V of Chapter 11.** If this sub-box is selected, attach the most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return, or if any of these documents do not exist, follow the procedure in 11 U.S.C. § 1116(1)(B).
  - ☐ A plan is being filed with this petition.
  - ☐ Acceptances of the plan were solicited prepetition from one or more classes of creditors, in accordance with 11 U.S.C. § 1126(b).
  - ☐ The debtor is required to file periodic reports (for example, 10K and 10Q) with the Securities and Exchange Commission according to § 13 or 15(d) of the Securities Exchange Act of 1934. File the *Attachment to Voluntary Petition for Non-Individuals Filing for Bankruptcy under Chapter 11* (Official Form 201A) with this form.
  - ☐ The debtor is a shell company as defined in the Securities Exchange Act of 1934 Rule 12b-2.
- ☐ Chapter 12

Phase One (Landlord Push)

- Really, much of a landlord’s positioning is pre-bankruptcy.
- Letter of Credit (LOC), personal guaranty or security deposits.
- If default pre-bankruptcy, get eviction judgment AND premises back prior to a BK filing.
- Once BK is filed, cannot change much. Pursue Section 365(d) admin rent.

Landlord Protections Against Tenant’s Financial Distress – Part I

- Protecting/Collateralizing the business relationship in event of financial distress.

- Letters of Credit (LOCs) = obligation taken on by a third party (a bank) to make payment once certain objective criteria are met – no further input from debtor.

- LOCs are preferred method over third party guaranty, advanced deposit and cash on delivery.

- Not subject to automatic stay, expand transaction base, replace borrower liquidity issues with bank stature. Perhaps no cap on rejection damages and avoid preference liability (but look when set up or changed).

Landlord Protections Against Tenant's Financial Distress – Part II

- Third-party guaranty generally not subject to automatic stay unless in its own BK or subject to a co-debtor stay (subject to additional litigation – Otero Mills injunction (contributing meaningful sweat equity or capital).

- While the letter of credit brings on additional financial support by way of a financial institution which has a certain measure of objective financial viability, the guaranty is a more subjective protection offered by the tenant.

- Absent guarantor bankruptcy, no preference liability if guarantor pays within preference period or even during the bankruptcy.

Landlord Protections Against Tenant's Financial Distress - Part III

- Security Deposits are most common used tools in leases. LOCs and personal guaranty may not be available in many lease situations.

- Deposits are considered property of the bankruptcy estate.

- Can be use to set off unpaid rent and perhaps reduce amount of deposit that needs to be returned. But deposits are subject to the automatic stay. Stay relief needed to draw down deposit, use as set-off, etc.

- Even if LL and tenant agree in use of deposit, likely should still get comfort order.

Tenant Must “Pay to Stay”

- *Tenant Must Pay Rent During Bankruptcy but not pay prepetition back-rent until lease assumption.*
- *Code gives Tenants up to 60-days to pay rent accruing in bankruptcy.*

- *Pandemic Effect: Mothballed cases, shelter in place and force majeure clauses, so some courts allow more time to pay the 60-day bankruptcy rent obligations if such administrative expense payments are assured in a plan, by financing, etc. (fact-specific)*

Admin. Rent – Billing Method v. Accrual Method

- Rent owed for tenancy occurring during the bankruptcy period is entitled to payment as an administrative expenses (higher priority than general unsecured claim). Sometimes called Administrative Rent.

- Courts have different methods for determining Admin Rent for the month the case is filed. Where case is filed makes a

Admin. Rent – Billing Method v. Accrual Method

- Assume a case is filed on August 13. Many jurisdictions will use the accrual method, which splits up the month between Admin. Rent for Aug. 13-Aug. 31, and August 1-12th is treated as a GUC.
- Some jurisdictions (include Delaware as Nation's busiest bankruptcy court for larger Chapter 11s) use a billing method, which looks at when rent is due. Since rent is due on 1st of each month (Aug. 1), the entire month is treated as prepetition GUC claim. Debtor friendly.

Phase One (Logistics Company Push)

- Focus also is pre-bankruptcy but with more options in bankruptcy.
- Letter of Credit (LOC), personal guaranty or security deposits.
- Cash on delivery (C.O.D) option more available in vendor/shipping situations.
- Critical Vendor/Warehouseman lien.
- Post-BK negotiation of deposits.

Vendor Protection

- Cash on delivery (C.O.D) option more available in vendor/shipping situations. Pre-bankruptcy, protects against preference action → contemporaneous exchange of value.
- Downside: without extension of credit likely lowers transaction base.

Critical Vendor & Essential Shipper Status

- Critical vendors are those so vital to the customer's continued operations that their refusal to continue supplying the customer might result in the termination of those operations and the inability to reorganize (first day motion but you will know pre-BK)

- Essential shippers provide the customer with specialized or high volume shipping services necessary to the customer's ongoing operations and finding another shipper and/or warehouseman would likely prove impossible.

Warehouseman Lien

- With a valid warehouseman’s lien, the warehouse operator can detain and have right to sell goods it is holding up to the value of the claimed outstanding charges.
- A warehouse receipt must state: warehouse location where goods are stored, date receipt issued, storage rate/ handling charges, description of goods or how they are packed & signature of the warehouseman or its agent.

Post-BK Negotiation of Deposits

- If not included in first-day motions (CV or WL), then consider negotiation of a post-BK deposit– but only for going forward goods and services.
- Cannot seek payment of pre-bankruptcy amounts owed. Potential negotiation to resolve any preference liability.

Phase Two

- Debtor's Goal: Attack

-- assume/reject executory contracts and leases

-- adversary proceedings (validity, priority and extent of liens, equitable subordination, substantive consolidation, etc.)

-- join forces with the Committee

Phase Two

- Lender’s Response: Posture
  - file proofs of claim
  - address/maximize value from executory contracts
  - defend/participate in adversary proceedings needed to support/each Plan Confirmation
  - respond to motion practice by Debtor, Committee, and junior constituents and keep tabs on case progress, especially if getting to a Plan or Sale in Bankruptcy is preferred over foreclosure/litigation.

Proofs of Claim

- In Chapter 11, creditors whose claims are listed in the correct amount and not listed as undisputed, unliquidated and not contingent (i.e., it is an agreed claim), do <u>NOT</u> have to file a claim and qualify for bankruptcy distribution.

Assume/Assign/Reject

- Adversary proceedings vary from case to case, so will focus on executory contracts/leases of real estate.

- Bankruptcy Code provides a debtor with some time to decide whether to assume or reject executory (unfinished) contracts or leases.

- Standard -- Debtor’s “business judgment”

- During this period, the debtor must keep current on its post-bankruptcy obligations on the contract/lease but does not have to catch up (cure) pre-bankruptcy obligations.

Assume/Assign/Reject

- Debtor has until plan confirmation to assume or reject an executory (unfinished) contract or residential real property lease. This period can be shortened upon request to the Court – case specific.

- Debtor initially has 120 days after filing of case to assume/reject nonresidential real property lease.

- 120-day period can be extended once for 90-days with or without consent of landlord for “cause”. This extension usually given if Debtor is current post-bankruptcy. (all other leases and executory contracts can be assumed at Plan Confirmation)

- Further extension beyond 210 days can only occur upon prior written consent of commercial landlord. Usually, landlords require catch-up payments as part of any further extension they may give, though greedy landlords that seek too much by way of cure payments can crater the case and leave them with unused tenant space in this market.

Assume/Assign/Reject

- Usually, by the 210-day deadline, debtor knows whether a lease/executory contract is marketable (i.e., below market) and/or whether it has the ability/need to assume same.
- If below market lease, the debtor will either assume the lease or will assign it to some third party for the benefit of the estate.

Assume/Assign/Reject

- Assumption/Assignment requires “prompt” cure and “adequate assurance of future performance”.
- “Prompt” not defined under the Code – case specific. Rule of thumb is to look at cure period in comparison with remaining duration of the contract/lease.
- Note: Merely staying current with postpetition obligations does not establish adequate assurance of future performance
- Debtor’s exit financing and tested financial projections are usually included as evidence of assurance of future performance if debtor merely assuming the lease/contract.

Assume/Assign/Reject

- For assignment of leases/contracts to third parties – generally the third party needs to show (1) financially viable -- via a mix of historical financials, current liquidity, and going forward projections; and (2) sufficient experience in the particular industry if specialized business being taken over in the space, i.e. a restaurant.
- A landlord MUST know that ***assignment in bankruptcy relieves a tenant of liability for any subsequent breach*** by the third party.

Assume/Assign/Reject

- Shopping Center leases have more requirements than other leases to satisfy “adequate assurance of future performance” including but not limited to tenant mix, radius, use, and exclusivity conditions to consider.

Assume/Assign/Reject

- Rejection – by affirmative choice or if debtor/tenant fails to elect by the deadline, the bankruptcy court will treat the rejection as a ***breach*** of the lease agreement, dating back to the time of filing.
- The effect of the breach is to give the landlord an unsecured claim for unpaid rents.
- Just like any other tenant breach outside of bankruptcy, once the tenant rejects the lease, the landlord is entitled to ***evict*** the tenant and collect ***damages.***

Assume/Assign/Reject

- In bankruptcy, however, there is a cap on the amount of damages a landlord is entitled to as a result of rejection. A landlord to the *greater* of 1 year rent <u>or</u> 15% of remainder of term not to exceed 3 years.

- If a non-tenant guarantor also files for bankruptcy in conjunction with the tenant, this cap probably should apply to the guarantor.

- Also capped are administrative expense damages if an assumed lease is subsequently rejected. A landlord’s administrative claim is capped at an amount up to monetary obligations due under the lease (except for penalty provisions relating to failure to operate) for two years after the <u>later</u> of: the rejection date or the date the premises are turned over to the landlord. Any damages exceeding the statutory cap are treated as unsecured claims.

Going Out of Business (GOB) Sales – retailer bankruptcies

Quick and Dirty on GOB Sales (issue for commercial landlords in retail bankruptcies in connection with leases to be rejected):

- Are contractual lease terms prohibiting GOB sales enforceable in bankruptcy? (not really)

- Do necessity and creditor fairness prevail over lease prohibitions? (yes)

- What can landlords control or modify here? (duration of GOB sales, hours of operation, mall regulations, signage/advertising).

Phase Three

- Debtor’s Goal: Emerge
- Creditor: Maximize Value
- Issues:
  - Exclusivity
  - Classification/Feasibility
  - Impairment/ Cramdown
  - Chapter 7 Test
  - New Value
  - 1111(b) Election
  - Section 363 Sales/1146 Exemption
  - Credit Bidding
  - Defending/Resolving Avoidable Transfer Actions

Exclusivity

- Debtor has exclusive right to file plan during first 120 days. This can be extended <u>or</u> shortened for “cause”.

- However, the 120-day period may not be extended beyond a date that is 18 months after case is filed.

Classification

- Creditor claims are classified for voting purposes according to their <u>nature</u>.
- All claims in a class must be of a similar character, but it is not necessarily true that all similar claims must be in the same class.
- Each secured claim/tranche will be in a class by itself.

Voting

- Voting is counted by <u>class</u>.

- If more than <u>one-half</u> in <u>number</u>, and more than <u>two-thirds</u> in <u>dollar amount</u>, of a class accept the plan, then the class has accepted the plan.

- Only <u>impaired</u> classes get to vote.

Confirmation Requirements re: Class Acceptances

- The debtor must obtain the affirmative acceptance of <u>at least one</u> impaired class.
- The plan fails if any impaired class rejects the plan, <u>unless</u> the debtor can "cram down" that class.

Cramdown Standards

- Secured creditors can only be crammed down by:

- (i) giving them a stream of future payments with a present value equal to the value of the collateral (i.e., the amount of the secured claim);

  - Grounds for attack by lender:

    - “Stretch-out” term is too long;
    - Interest rate is too low;
    - Plan is not economically feasible

- (ii) selling the collateral and giving them the proceeds; or

- (iii) giving them the “indubitable equivalent” of their secured claim.

Cramdown Standards (continued)

- <u>Unsecured</u> creditors can only be crammed down:

- (i) if junior classes (i.e., equity) get <u>nothing</u> under the plan (i.e., equity is wiped out);

  <u>OR</u> (???????????)

- (ii) if equity contributes "new value"

  – Grounds for attack by lender:

    - New value not sufficient in amount;
    - New value not money or money's worth ("sweat equity" is not new value);
    - New value must be subject to market testing (LaSalle)

1111(b) election:

- Allows under-secured lender to elect to "unbifurcate" its claim and have the full amount of its claim deemed secured.

- Where collateral has decreased in value, the election prevents the debtor from "stripping down" the lender's lien and depriving lender of participation in future appreciation of the collateral.

- In some cases, the election will also (i) increase the amount that the debtor must pay under the plan and (ii) make it more difficult for the debtor to prove feasibility. The debtor can cramdown down the secured claim only by making a stream of payments with (i) a present value equal to the value of the collateral and (ii) a total value (i.e., non-present value) equal to the total amount of the secured claim.

Nuanced 363 sales issues in Chapter 11

- Correctly sequencing 363 sales/Chapter 11 plans.

- Doc Stamp Transfer tax avoidance under Section 1146(a) – *Piccadilly case*. Closing date must occur post-confirmation. Room for creativity here.

Limiting Credit Bid Rights under 363(k)’s “for cause” standard

- Refresher – A credit-bid is nothing more than the offset of a secured claim against the property’s purchase price.

- Rather than have (i) creditor pay purchase price to the debtor, and (ii) debtor return the purchase price to the creditor as proceeds of its collateral, the secured creditor can make a bid that would simply cancel out the two obligations and short-cut the back-and-forth payment of cash.

Limiting Credit Bid Rights under 363(k)'s "for cause" standard

- The ability to credit bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price and it enables the creditor to purchase the collateral for what it considers the fair market price (up to the amount of its security interest) without committing additional cash to protect the loan.

- However, even where a valid lien exists, the court may prohibit or restrict credit bidding "for cause."

Limiting Credit Bid Rights under 363(k)'s "for cause" standard

- The holding and discussion in *Fisker Automotive Holdings, Inc. – 510 B.R. 55 (Bankr. D. Del. 2014)* provided some guidance regarding the meaning (and seemingly expansive trend) of "for cause" for purposes of section 363(k).

- *Fisker* and cases like it sent shockwaves throughout the bankruptcy community when <u>they limited the amount of a secured claimant's credit bid rights to the amount it paid for its debt, not the face value of the debt it purchased</u>.

Limiting Credit Bid Rights under 363(k)’s “for cause” standard

- These cases involved:

(1) bona fide disputes as to the scope and validity of the liens on the collateralized assets;

(2) aggressive loan-to-own strategies as part of the bankruptcy proceedings, inferring a misconduct (or less than completely appropriate conduct) element; and

(3) the credit bid amount if not restricted would have chilled the bidding.

Limiting Credit Bid Rights under 363(k)'s "for cause" standard

- Critics of these cases (i.e. lender groups) focus on this last notion as being too expansive in that it could relate to EVERY auction sale of collateralized assets.

- However, it seems the first two features of overzealous loan-to-own conduct and uncertainty regarding the scope, validity and perfection issues as to the liens on the assets themselves are trigger points that together seemingly provide context "for cause" under 363(k).

Vendors – Preferential Transfers

- Harshest law in bankruptcy is preferential transfers - payment received from a customer on a prior debt within 90 days prior to its bankruptcy.

- “No-fault” law -- subject to many defenses, and 99% of cases don't go to trial but get settled; rarely an all-or-nothing proposition; pay for peace.

- Records of unpaid invoices, payment history going back about a year, and other industry invoice/payment records are vital. DHL business units working together with Legal.

- When in doubt about whether to take customer’s payment … ALWAYS TAKE THE MONEY!

Preferential Transfer Defenses

- Main defenses include:

(a) new value defense (would need records of unpaid invoices);

(b) ordinary course of business defense (would need payment/billing history going back about a year before bankruptcy and other industry invoice/payment records); and

(c) contemporaneous exchange of value – (think C.O.D.)

Fraudulent Transfers

- Most fraudulent transfer cases are "constructive" fraudulent transfer cases -- i.e. filing entity insolvent/near insolvent when transfer made and did not get reasonably equivalent value in return.

- Vendors mostly are not as vulnerable on fraudulent transfers, because receive money in exchange for goods or services, but if get paid by a corporate parent and services provided to an affiliate, this could lead to exposure. Also in an overbilling situation.

- If "actual" fraudulent transfer case -- filing entity does not need to be insolvent, just made transfer with specific intent to keep stuff away from creditors.

- Defenses: providing value for the transfer <u>AND</u> receiving transfer in good faith (i.e., w/o knowing about insolvency or other bad business issues).

- Fraudulent transfers have claw-back periods ranging from 2 years to 6 years (state law)

Other Avoidable Transfer Considerations

- Also may be able to offset (legally or for settlement purposes) certain monies owed on your bankruptcy claim amount, but usually not dollar-for-dollar -- your dollar gets treated as cents.

- These lawsuits (preferences & fraudulent transfers) usually get brought toward the end of the cases as bankruptcy estate has 2 years from filing date to pursue these lawsuits and usually administers the estate's concrete assets first before seeing if these other lawsuits are necessary.

- So while it is good that bankruptcy estate waits (because suits may not be necessary), it is bad because they are almost always necessary and your company's records with this customer become stale, archived or destroyed. Your records are "key" to providing defenses to these lawsuits.