

SEVEN WAYS TO LEAVE YOUR CREDITORS

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Introduction

- Financial Distress may require the retention of insolvency professionals.
- Bird's Eye view of various remedies available to address creditor issues:
 - Bankruptcy
 - State and Federal Court Receiverships
 - Assignments for the Benefit of Creditors
 - Trust Mortgages
 - Voluntary Surrender and Uniform Commercial Code Article 9 Sales
 - Fiduciary Alternatives

Bankruptcy – General Concepts

- **The Bankruptcy Estate:**
- **The Automatic Stay:**
 - An injunction against creditor action
 - It may be modified for cause
 - Only enjoins actions against property of estate, not against other parties who may be liable for debt.



Bankruptcy – General Concepts

- **Distribution of Assets:**
 - Priority scheme of the Bankruptcy Code:
 - Multi-tiered waterfall - most senior class of creditors get paid in full before creditors in the next pool down are entitled to receive anything.



Bankruptcy – General Concepts

- **Chapter 11 Bankruptcy:**
 - Debtor continues business operations
 - Bankruptcy court in control of major decisions
 - Sale of assets
 - Entering into or rejection of leases
 - Financing arrangements
 - Shutting down/expanding business operations
 - Entering into or modifying contracts and agreements
 - Retention and payment of professionals



Bankruptcy – General Concepts

- **Role of Creditors:**
 - Can oppose proposed action of debtor
 - Formally vote on chapter 11 plan
 - Unsecured creditors' committee



Bankruptcy – General Concepts

- **Chapter 11 Plan:**
 - Reorganize and restructure financial affairs
 - 363 sales and liquidating plans
 - Creditors vote on plan, at least one class of “impaired” claim must vote in favor of plan
- **Plan Confirmation:**
 - Creditors entitled to vote, but bankruptcy court has ultimate authority to confirm the plan
 - Section 1129 sets forth 16 requirements to confirm.
 - Cram down

Bankruptcy – General Concepts

- **Chapter 7 Bankruptcy:**
 - Chapter 7 Trustee is appointed to take over the business and liquidate its assets. Principals wash their hands of liquidation process.
 - Bankruptcy court must still approve Trustee's actions



Bankruptcy – General Concepts

- **Chapter 7 Bankruptcy (Cont'd):**

- Creditors also have rights to object to such actions.
- Automatic Stay and claim distribution scheme all apply in a Chapter 7 case.
- There is no requirement that Administrative and Priority claims be paid in full.



Bankruptcy – General Concepts

- **Involuntary Chapter 7 or Chapter 11:**
 - Requires a showing of insolvency and three creditors holding non-contingent claims aggregating at least \$15,775.00 that are not subject to a bona-fide dispute.
 - Rarely used remedy as filing creditors and a risk of the imposition of sanctions if the court dismisses the involuntary petition.



Federal & State Court Receiverships

- Receiver is an officer of the court-takes control of all property
- Receivership is a creditor remedy requested in conjunction with litigation



Federal & State Court Receiverships

- Used in the dissolution of a corporation, a dispute among shareholders, in pursuit of a judgment. Most often used in a foreclosure of real property to take possession and protect from waste.
- The order appointing the receiver will spell out his/her powers and duties.
- Most of the Receiver's actions must be approved by the court.

Federal & State Court Receiverships

- **Federal Court Receivership:**
 - No Federal Statute governing appointment of receivers.
 - There must be federal court jurisdiction over the claims in general
 - Court will have jurisdiction over receivership property wherever it is located.
 - Specific federal statutes govern sale of property and public or private sales.
 - Claim Priorities: subject to approval by court.

Federal & State Court Receiverships

- **State Court Receivership:**
 - Michigan Court Rules govern the appointment of receivers in Michigan Courts.
 - Court may, but need not, defer to the petitioning party's choice of receiver.
 - Receiver must be qualified.
 - Will authorize receiver to bring suit. The receiver may not sell real property without a separate order of the court.
 - Claim priorities: Priorities are based on state law.
 - Michigan recently adopted the Uniform Commercial Real Estate Receivership Act.

Assignment for the Benefit of Creditors

- Court proceeding.
- Debtor voluntarily executes an assignment turning over its assets to an assignee chosen by debtor.
- Assignee is Trustee of the estate of the debtor for the benefit of the debtor's creditors.



Assignment for the Benefit of Creditors

- Assignee is Trustee of the estate of the debtor for the benefit of the debtor's creditors.
- Assignee may request that the court enjoin creditor collection activity.
- Statute sets forth powers of Assignee. Similar to a receiver or bankruptcy trustee.



Voluntary Surrender and Article 9 Sales

- Applies to Personal Property, not real estate.
- Surrender property to lender and Article 9 of the Uniform Commercial Code allows lender to sell property at public or private sale.



Trust Mortgages

- No court oversight.
- Debtor turns over assets to Trustee of its choosing. Trustee liquidates assets and distributes proceeds out of court.
- Priority scheme is agreed to and set forth in the agreement appointing the Trustee. Generally follows Bankruptcy Code priorities.
- No injunction.
- May give creditors comfort to be part of a claims process.

Fiduciary Alternatives:

- Appoint a chief restructuring officer or retain financial advisors.
- No creditor protection.
- May give debtor credibility with its creditors.

Retain Control and Liquidate:

- Liquidate assets and distribute whatever proceeds are available to creditors.
- Least expensive, but highest risk.
- Likely only to work when creditors are not aggressive or there are sufficient funds to pay creditors in full.

Practice Considerations:

- The earlier the debtor seeks to address its creditor problems, the more options will be available.
- Signs of impending insolvency:
 - Judgments entered against the debtor, or lawsuits filed by its creditors.
 - The presence of unpaid state or federal withholding taxes.
 - The debtor is in a workout or forbearance agreement with a lender.
 - Major pending litigation.



Practice Considerations:

- Out of court options provide more of an opportunity to be involved.
- Have client pay retainer as advance payment to cover final tax returns.
- Consideration when being retained as accountant in a bankruptcy case.
- Status quo should be maintained. Avoid the temptation to transfer assets out of creditors' reach.

