

**Doing Business
With
Financially Troubled
Companies**

Presenters



Primerus
Member

Brian L. Davidoff
Managing Director
Rutter, Hobbs & Davidoff
Incorporated

Karen B. Polyakov
Corporate Counsel
Home Depot U.S.A., Inc.



Primerus
Member

David S. Schaffer
Partner
Kubasiak, Fylstra, Thorpe &
Rotunno, P.C.

Christopher L. Picone
President & General Counsel
Buccino & Associates, Inc.

Presented in Conjunction With



Primerus

Built on Integrity. Driven by Innovation.

Warning Signs

**Christopher L. Picone
President and General Counsel
Buccino & Associates, Inc.**

Probability of Fatality for High-Risk Activities

Activity

Indianapolis 500 (10 races)



Probability of Fatality

5%

Activity

Sport Parachuting (1000 jumps)

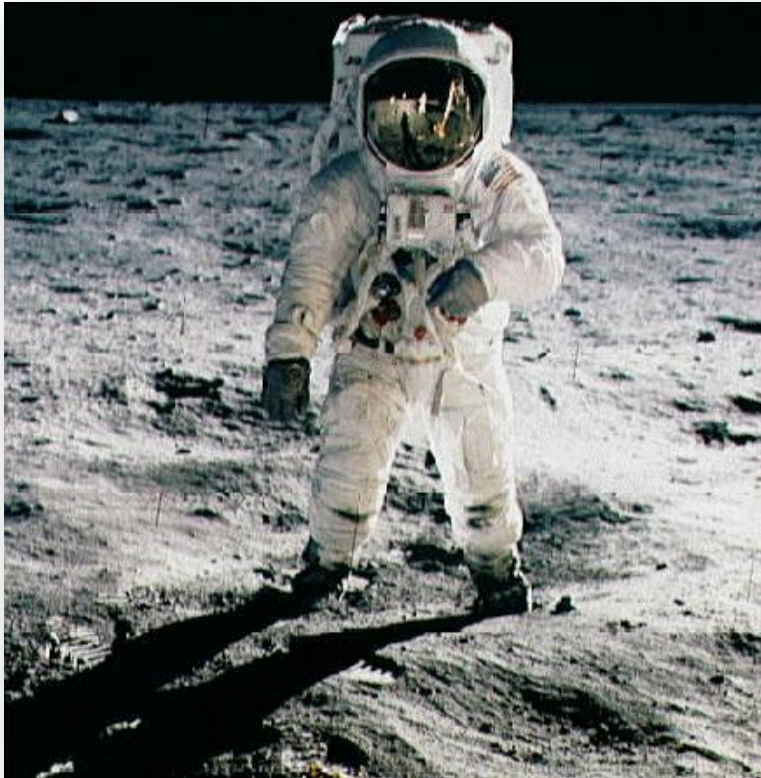


Probability of Fatality

6%

Activity

Astronaut (10 missions)



Probability of Fatality

20%

Activity

Ascending Mt. Everest (1 attempt)



Probability of Fatality

30%

Activity

Going Over Niagara Falls In A Barrel

(1 time)



Probability of Fatality

33%

Activity

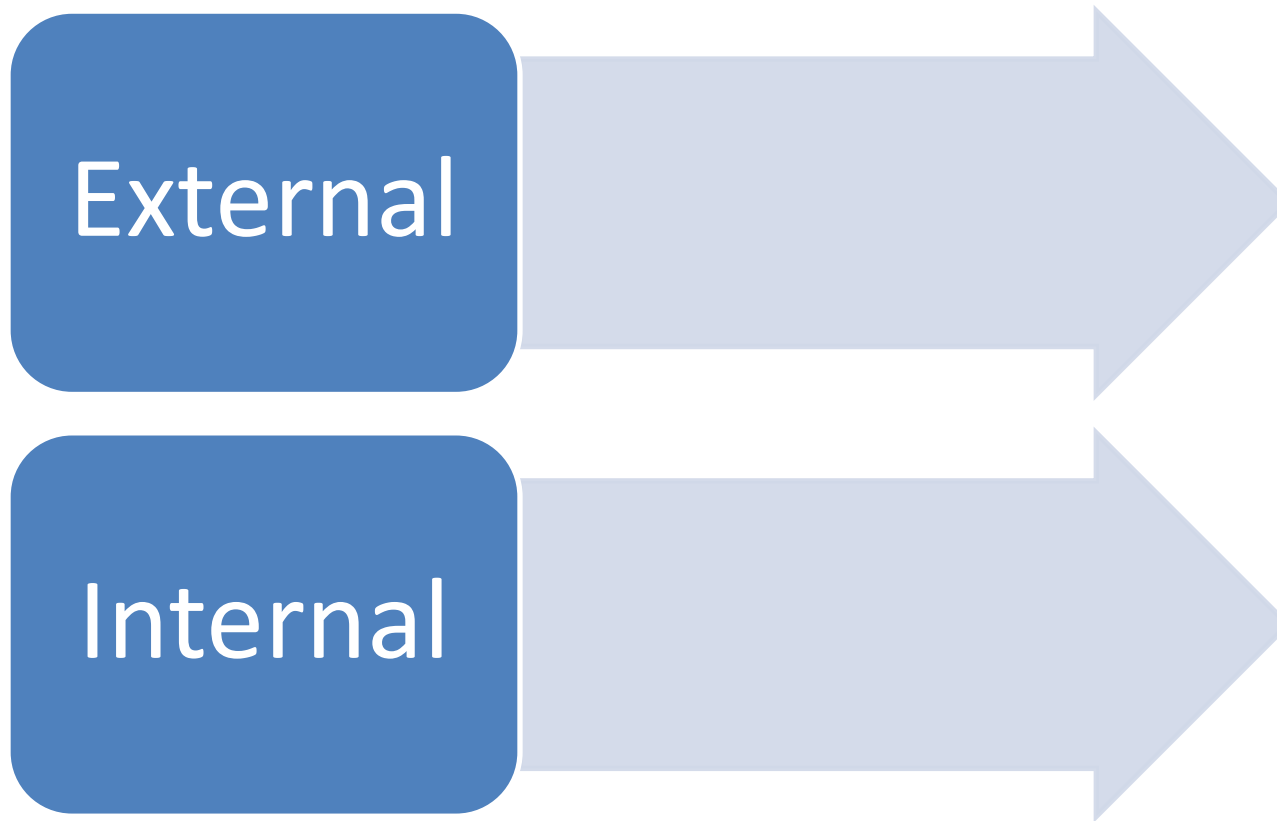
New Business In 1-5 Years



Probability of Fatality

51%

Reasons For Business Failure



External

Competitive Changes

(Foreign Competition, Mergers, Low-cost Producers...)

Economic Factors

(Inflation, Demand, Interest Rates, International Monetary Reasons...)

Technological Changes

Social Changes

(Lifestyle, Consumer Decline, Attitude Toward Pollution...)

Government Constraints

(Legislation, Taxes, Pollution Control, Product Safety...)

Internal

Inadequate Leadership

Improper Business Planning

Poor Asset Management

Failure To Change

Inadequate Control Systems And MIS

Lack Of Sales Volume

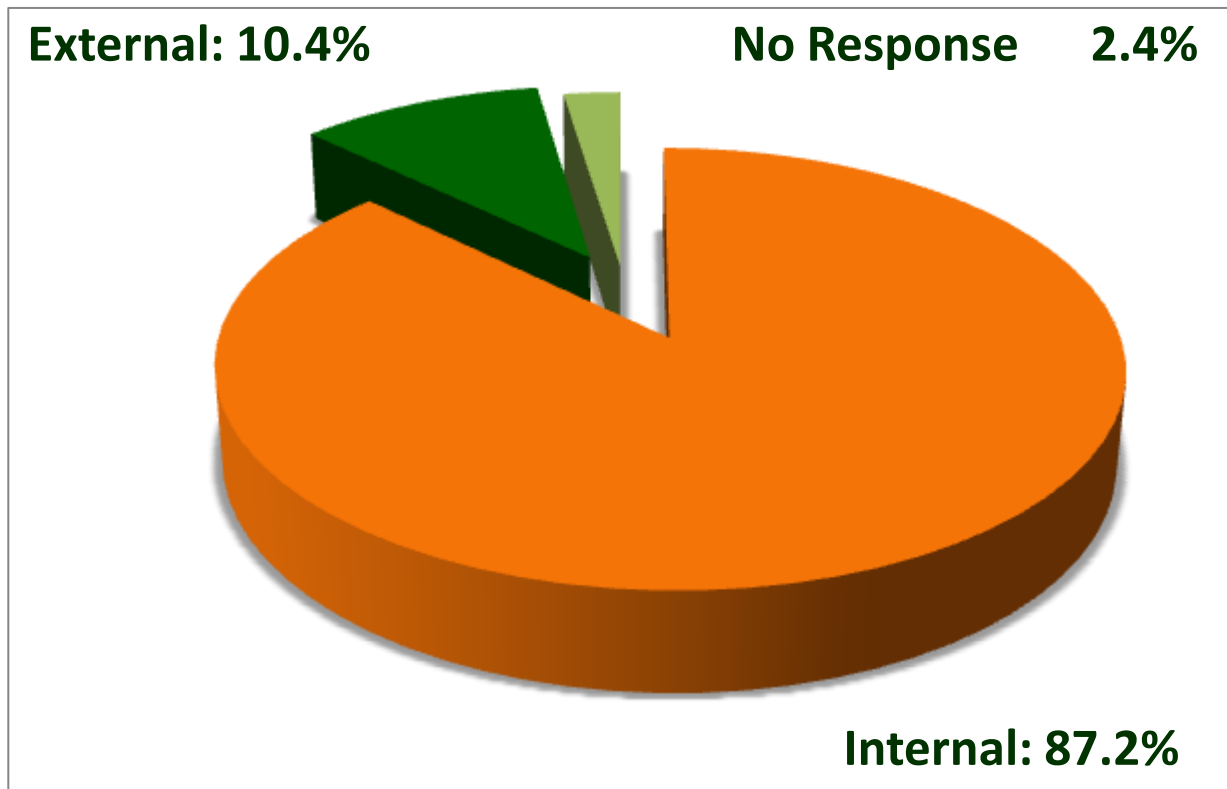
Over Expansion

Customer Concentration

Poor Pricing

Excessive Debt

Reasons For Business Failure



Business Distress

Warning Signs Normally Present
For Up To Three Years

Customers

- **Product Return**
- **Slow Pay**
- **Reduced Order Levels**
- **Loss of Customer and Customer Concentration**

Creditors

- **Lender Issues** (Reduced Advanced Rates; Default Interest Rates, etc.)
- **Supplier Issues** (Reduced Lines Of Credit; Reduced Terms; Out Of Stock, etc.)

Employees

- **Morale**
- **Reduced Productivity**
- **Quality Control Issues**

Income Statement Issues

Sales

- Sales Shortfall vs. Plan
- Low-margin Volume To “Cover Overhead”
- Forecasts And Investment Based On Accelerated Growth Rate

Costs and Expenses

- Decreased Gross Margins
- Increased Customer Return Of Product
- Increased SG&A As Percent Of Sales
- Increased Warranty Expense

Balance Sheet Issues

Increased Aging Of Accounts Receivable

- “Receivables” Reflect Operational Problems

Increased Aging Of Inventories

- Poor Mix Between Customer Orders And Production/Purchasing

Balance Sheet Issues (cont.)

Increased Prepaid Assets

- Expenses Are Being Deferred Rather Than Charged To Income Statement

Increased Accounts Payables

- Vendor Payments Are Being Delayed

Recommendations



Do Not Ignore Early Warning Signs



Tighten Credit Terms

- ✓ COD
- ✓ Reduce Credit Limits
- ✓ Reduce Number of Days for Payment
- ✓ Obtain additional security or collateral such as Letter of Credit, Personal Guaranty, Trade Credit Insurance, Perfected Security Interest in the Subject Goods

Recommendations (cont.)



Negotiate payment plan (perhaps with interest and/or additional security) for past due balances and make sure plan is followed.



If acceptable new credit terms cannot be agreed upon in a reasonable amount of time, cease all shipments and begin collection process immediately. It is preferable to be a judgment creditor than an unsecured creditor.

Pre-Bankruptcy Contract Issues

**Brian L. Davidoff, Managing Director
Rutter, Hobbs & Davidoff Incorporated**

**Karen B. Polyakov, Corporate Counsel
Home Depot U.S.A, Inc.**

The Bankruptcy Players

Executory Contract Issues

- Is the Agreement an Executory Contract?
- Right of DIP to Assume or Reject An Executory Contract

Effect of Assumption or Rejection

Assumption

Rejection

- Effect of Rejection on Termination of Agreement
- Effect of Rejection on Restrictive Provisions

Effect of Rejection on License Provisions

- Rights Retained Under Agreement
- Obligations Under Intellectual Property Licensing Agreement Where Debtor is Licensor
- Licensee's Obligation to Make Payment
- Licensee's Right to Damages

Assignment of Executory Contracts

- Right of Assignment
- Ipso Facto Clauses

Bankruptcy Issues

David S. Schaffer

Partner

Kubasiak, Fylstra, Thorpe & Rotunno, P.C.

Avoidance

§ 544 – Avoid Liens Not Perfected Prior To Bankruptcy Filing

§545 – Avoid Certain Statutory Liens

§547 – Avoid Preferences

Preferences

§547 – A Pre-petition Transfer Of Property To Creditor Can Be Avoidable

Is The Creditor's Claim Subject To An Avoidable Transfer

A Transfer Can Be Avoided Only If The Value Is Greater Than \$5,850

Defenses To Preferences

Transfers In The Ordinary Course Of Business

Fraudulent Conveyances: 2 to 4 Year “Look Back” Period

State Law

Bankruptcy Code

Ways to address these issues prior to, or at time of, Bankruptcy Filing

- ✓ Consignments
- ✓ Obtain Letters of Credit and Third Party Guarantees
- ✓ Trade Credit Insurance
- ✓ Halt Sales
- ✓ Rights of Setoff
- ✓ Security Interest in subject goods
- ✓ Reclamation

Automatic Stay Issues

Automatic Stay's Impact on Litigation

Co-Defendants

Suit-Stayed

Litigation with a DIP

**Brian L. Davidoff, Managing Director
Rutter, Hobbs & Davidoff Incorporated**

**Karen B. Polyakov, Corporate Counsel
Home Depot U.S.A., Inc.**

Arbitration Issues in Bankruptcy

The Claim-Specific, Case-Specific Approach

The Core/Non-Core Distinction Approach

Bankruptcy Jurisdiction

- Choice of Forum Strategy
- Statutory Jurisdiction
- Core/Non-Core Jurisdiction
- *Stern vs. Marshall*
- Related to Jurisdiction
- Third Party Claims

Withdrawal of the Reference

- Discretionary Withdrawal
- Mandatory Withdrawal

Abstention

- Mandatory Abstention
- Permissive Abstention

Removal and Remand

Removal

- 28 U.S.C. Section 1452(a)

Remand

- 28 U.S.C. Section 1452(b)

Jury Trials

- 28 U.S.C. Section 157(e)
- *Lagenkamp vs. Culp*
- *Granfinanciera S.A. vs. Norberg*

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