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Know Your Alternatives

Common Non-Bankruptcy Alternatives in Troubled Loans

Eric L. Johnson, Kansas City
Eric C. Peterson, St. Louis

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Agenda

- Why Use a Bankruptcy Alternative?
- Common Bankruptcy Alternatives
  - Receivership: State and Federal
  - Assignments for the Benefit of Creditors
  - Forbearance, Composition, and Deed in Lieu Agreements

Why Use a Bankruptcy Alternative?

- Certain situations do not demand all the protections of the Bankruptcy Code or can support the costs.
- Over the past several years, several states have sought to modernize state insolvency laws.
- Higher acceptance by lenders who view the speed and lower cost as being advantageous.
- Debtors may desire to avoid a stigma of a failure associated with a liquidation under the Bankruptcy Code.
- Greater flexibility for both debtors and creditors.
- More prompt and speedier distributions to creditors.
- Receiver may have the ability to bring claims a bankruptcy trustee cannot bring.

Bankruptcy Alternatives Drawbacks

- Lack of Uniformity
  - Free and clear sales not always possible
  - Stay of litigation not always possible
- Jurisdictional Constraints
  - State courts have limited jurisdictional reach
  - Federal courts bound by subject matter jurisdiction
- Federal Priority Statute
- State and federal district courts may not be as accustomed to liquidations and insolvency situations as the bankruptcy courts.
  - Rise of Commercial Courts
- Receivers and assignees not vested with same expansive powers as a bankruptcy trustee.
- Can trigger involuntary bankruptcies.

Types of Bankruptcy Alternatives

- Receiverships
  - State receiverships
  - Federal receiverships
- Assignment for the Benefit of Creditors
  - Statutory
  - Common law
- Forbearance and Composition Agreements

Receiverships

Receivership

State Receiverships

- General vs. limited
- Limited jurisdictional reach
- Need of ancillary proceedings
- Laws can vary from state to state
  - Injunctive powers
  - Free and clear sales

Federal Receiverships

- Jurisdiction
  - Limited by subject matter jurisdiction
  - Nationwide jurisdiction
  - 28 U.S.C. § 754
- Injunctive powers
- Arduous sale requirements
  - 28 U.S.C. §§ 2001, 2002, and 2004.
- Better suited for regulatory enforcement than debt collection

Powers of a Receiver

- Powers will be laid out by the receivership order and/or receivership statute.
- Court has power to enlarge or restrict powers.
- Powers will depend upon whether the receivership is limited or general in nature.
- Common powers:
  - Secure and liquidate assets
  - Operate the debtor's business
  - Retain professionals
  - Assert claims and causes of action including fraudulent transfer claims
  - Intervene in pending actions
  - Compel information related to receivership assets or matters that may impact receivership estate.

Duties of a Receiver

- Established by receivership order and applicable law.
- Duties will vary depending upon whether limited or general receivership.
- Common duties:
  - Obtain a bond
  - Reporting to the court and parties
  - Account for receivership property
  - Exercise proper business judgment in handling estate assets
  - Comply with applicable federal and state law

Assignments for the Benefit of Creditors

ABC Basics

- An assignment for the benefit of creditors (ABC) is a voluntary transfer by a debtor of its property to another person or entity as an assignee, for the purpose of liquidating the debtor's assets and distributing pro rata to all unsecured creditors the net proceeds.
- Depending on jurisdiction can be statutory or by common law.
  - *See e.g.,* Mo. Rev. Stat. 426.010-426.410; *Jones v. Fid. Nat'l Bank & Trust Co. of Kansas City*, 243 S.W.2d 970, 976 (Mo. 1951). Missouri has both options.
  - Normally the common law assignment allows for a speedier and more flexible procedure.

ABC Advantages

- Debtor may desire to avoid a stigma of a failure associated with a liquidation under the Bankruptcy Code.
- Debtor as well as creditors may desire that the liquidation be accomplished with greater flexibility and without the formalities and supervision of the Bankruptcy Court.
- Selecting an experienced fiduciary to liquidate the company can bring legitimacy to the process and in some cases, creditors will stand-down in litigation attempts – **communication is key.**

ABC Disadvantages

- No discharge
- Can itself serve as a basis for an involuntary bankruptcy
- No automatic stay
- Need secured creditors consent to sell collateral and use cash collateral
- In common law ABCs, no court available to readily resolve disputes
- Subject to Federal Priority Statute

Beware the Federal Priority Statute

- **Key Statute: 31 U.S.C. § 3713**
  - Requires a claim of the U.S. government to be paid first under certain situations regardless of state law
  - Example of government claims: taxes, SBA liability
  - Estate representative has personal liability for any payments made in violation of statute
- **Elements**
  - Debtor is indebted to the government
  - Debtor is insolvent
  - Debtor either makes a voluntary assignment of property, property of debtor, if absent, is attached, or an action of bankruptcy is committed, i.e., ABCs, receivership
- **Exceptions**
  - Statutory exception: Does not apply in cases under the Bankruptcy Code
  - Limited Judicial Exceptions:
    - Government claim must exist at time "action of bankruptcy committed"
    - Priority statute inconsistent with other federal law
    - Subject to "specific and perfected lien" held by secured creditor. ***Caution: This exception is not as straight forward as it seems.***
- **Take Away:** If an asset is to be sold and distributed in a receivership or ABC, a full evaluation should be made as to any federal claims and how they are to be paid. In certain instances, it may be better to sell through a bankruptcy proceeding.

Forbearance, Composition, and Deed in Lieu Agreements

Forbearance Agreements

- An agreement between a lender and the borrower that delays loan enforcement subject to certain conditions being satisfied.
- Establishes the new rules of the road for the relationship and provides both the borrower and lender some sense of certainty as they attempt to navigate a troubled loan.
- Most common between borrowers and secured lenders, especially where the borrower needs the lender's collateral to operate its business
- Common terms:
  - Ratification of the debt
  - Release of claims
  - Collateral liquidation plan
  - Additional security
  - Performance benchmarks
  - Tolling provisions

Composition Agreements

- The borrower will make a proposal to its creditor body asking that in exchange for accepting a one-time payment or a series of payments, the creditor will accept less than the total amount due to it. Such proposal is generally accompanied by financial disclosures.
- Generally, an agreement with the unsecured creditors.
- Benefits
  - Eliminates burden of administrative overhead of a more formal insolvency proceeding.
  - Reduces creditor loan enforcement costs in terms of both money and time.
- Drawbacks
  - Becomes less effective when creditor pool is large and diverse. Works best where there is a small and known creditor pool.
  - Borrower should be cognizant of any forgiveness of debt income issues.

Deed in Lieu Agreement

- Agreement where borrower voluntarily conveys real property to secured lender outside of foreclosure action.
- In judicial foreclosure states, a deed in lieu can rapidly shorten time to get through the foreclosure process. In non-judicial foreclosure states, can still be helpful, but depending upon notice and redemption periods, not as effective or necessary.
- Ideal in situations where the title to the property is relatively clean and the loan is without recourse and/or lender willing to forgo collection of any deficiency against borrower and/or guarantors.
- Any deed in lieu should be clear there is no merger of title with the mortgage or release of the underlying debt. It may be the case the lender will still need to effectuate an action to foreclose any junior liens or other encumbrances.
- A lender will want to work with its title company if pursuing this path to obtain a good title policy.
- Can be used in connection with forbearance agreement.

Questions

THANK YOU



Eric L. Johnson
Partner
Kansas City
816-292-8267
ejohnson@spencerfane.com



Eric C. Peterson
Of Counsel
St. Louis
314-333-3937
epeterson@spencerfane.com

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