

RENAISSANCE

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Choosing a Venue in Chapter 11 Cases: A Practical View

By Bobby Guy



Bobby Guy

There was a time in the late 1990s when bankruptcy lawyers joked it might be malpractice to file a Chapter 11 bankruptcy anywhere outside of Delaware. Like all good humor, it had some basis in the truth: A major advantage of Chapter 11 is that a company can file bankruptcy anywhere that one of its affiliates is incorporated or has so much as an equipment shack or one-person office it can call a principal place of business

or principal asset. As a result, the business' lawyers usually get a wide choice of places to initiate a Chapter 11, and at times, Delaware has been the most popular because of its sophistication and consistency.

What are the major issues that go into choosing where to file a Chapter 11 case? A number of articles are published annually about the legal differences that distinguish bankruptcy courts from one another; instead of competing with those articles, the goal here is to examine the more practical issues and anecdotal examples that counsel, turnaround managers and the C-suite team should consider when choosing a venue.

Without a doubt, predictability is the issue that encompasses all other considerations. The Western legal system is based on it, and unpredictability is anathema to lawyers in all fields and their clients. When choosing venues for their bankruptcy proceedings, businesses can ensure a more predictable ride by considering the following elements:

Consistent and Responsive Courts

Filers should be wary of courts that do not have reasonably good and responsive first-day procedures. Nothing is worse than filing a Chapter 11 and not getting a first-day hearing for weeks or even

months — one West Coast company shut down several years ago after being forced to wait 10 days for a first-day hearing. Companies need to have first-day hearings promptly so that they can access cash, pay employees, continue centralized cash management and pay essential suppliers. Poor first-day hearing procedures can also signal a more general lack of responsiveness, a major stumbling block for operating companies in Chapter 11, which often need to schedule emergency or expedited hearings. Delaware and the Southern District of New York have led the way on first-day responsiveness and many other courts, such as the Southern District of Texas, have followed suit by adopting similar local rules and procedures.

Consistency in courts is also vital, not just on the law, but among judges as well. In a district with multiple judges, if drawing the wrong judge can result in a completely different outcome, the district is not likely to be a popular one. Highly consistent bankruptcy courts are sometimes dubbed “debtor-friendly,” but a better phrase would probably be “value- and-process-friendly.”

A Receptive and Flexible U.S. Trustee

In many jurisdictions, the U.S. Trustee's office sees a constant flow of Chapter 11s, works with attorneys regularly and has clear policies about how to handle standard issues. Other U.S. Trustee offices may be much less experienced and less responsive to Chapter 11 cases, however. This is an important consideration, because skirmishes with the trustee can quickly become a thorn in the debtor's side. Unlike private parties who have an incentive to settle, government employees approach the case solely from a precedent and policy standpoint, meaning the debtor can only offer logic to the U.S. Trustee to eliminate objections.

Major issues to consider regarding U.S. Trustees are receptiveness to the “Jay Alix Protocol,” which sets limits on hiring advisors during the bankruptcy process that were involved in the company before the filing; the trustee's stance on professional payments to advisory

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Reflecting on 30 years with MorrisAnderson

An interview with Alan Glazer, Senior Principal

30th
ANNIVERSARY

How long have you been with MorrisAnderson?

Since the beginning. The firm was founded by Dan Morris and Dave Anderson in the early '80s and I'm proud to say that since then, we've stayed committed to the founding principles — a strong dedication to high quality, value-added professional services, ethical conduct, building enterprise value for our clients and their stakeholders, and creating career opportunities for our people.



Alan Glazer

Why is this 30-year milestone important?

Because it shows both strength and flexibility. We were an early industry pioneer and have succeeded despite increased competition and economic turbulence. It validates that what we do for our clients is needed and unique in the marketplace.

What major changes have you seen in the turnaround industry over the past 30 years?

Our industry has experienced increased recognition, acceptance and growth, and as a result, is bigger and more structured. There are more alternatives than ever, so competition is increasingly tight — that's why MorrisAnderson must be better than our competitors in all critical performance metrics to sustain growth. We've also seen the turnaround used more often as a viable alternative to liquidation, which implies increased patience on the part of the stakeholders.

Looking forward, what do you see for MorrisAnderson?

What do you see happening in the industry?

I see MorrisAnderson continuing to operate as a unified firm that invests heavily in its people. We are committed to hiring, retaining, motivating and compensating high-quality professionals to deliver value to our clients and their stakeholders. I think this is what separates us from our competitors.

Related to the industry in general, there will always be change — our industry exists because businesses have difficulty recognizing and responding to change. As long as there are financing issues, generational issues, human resource issues — our expertise will be in demand.

Questions posed by Amanda Hansen, Senior Marketing Manager, MorrisAnderson.

Change of address: Send old and new addresses to Renaissance, c/o Charlene Zielinski, MorrisAnderson, 55 W. Monroe, Suite 2500, Chicago, IL 60603, or send all old and new contact information by e-mail to updates@morrisanderson.com.

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Choosing a Venue in Chapter 11 Cases: A Practical View, *continued from page 1*

firms; and flexibility in how fees are allocated between debtors in a multisubsidiary case. Flexibility on cash management is especially important, since the company's bank may be noncompliant with the bankruptcy bonding standards. In this event, unless the trustee is flexible for a few weeks while the debtor works with its bank to become compliant or moves accounts, serious disruption in a debtor's business and cash flow can follow.

Companies should also research the U.S. Trustee's procedure and timing in appointing the unsecured creditors committee when choosing a bankruptcy venue. In general, quick selection and organization of the unsecured creditors committee is best for all parties involved. Timeliness varies by office: Some trustees handle this within 10 days, while others can take 30 days or more. Procedural details also vary from district to district. Some trustees appoint bondholders instead of indenture trustees to committees, for example, and some appoint different committees for separate debtors instead of a consolidated committee.

Differences in Rulings Among Circuits

If anyone believes that the law is only a minor factor in deciding venue, consider the so-called "Capital Factors" decision by the U.S. Court of Appeals for the 7th Circuit that prohibited critical vendor payments in Kmart Corp.'s bankruptcy. Before that case, some were beginning to favor Chicago as a national venue for bankruptcies. Many argue that Capital Factors has sent subsequent major cases eastward.

Major legal issues to consider in the venue decision include the ability to pay critical vendors, get third-party releases in a plan of reorganization, pay reasonable break-up fees and run quick "363" sales. A couple of anecdotal examples found off the beaten path are worth mentioning.

Many jurisdictions allow a lease guarantor to cap lease guaranty liability at one year, but other courts, such as the Northern District of Georgia, have found that lease guarantees are not capped. For national retailers or other debtors with significant lease obligations, filing in Georgia instead of another district could cost them potentially hundreds of millions of dollars. In addition, a court's willingness to separately classify the deficiency claim of a secured creditor from other unsecured creditors can affect a company's reorganization plan significantly. The U.S. Court of Appeals for the 6th Circuit, for example, has generally upheld separate classifications of a secured creditor's deficiency claim, meaning that the debtor is often able to get the unsecured class to vote for the plan of reorganization, no matter how large the secured creditor's remaining claim may be. This can be the difference between a confirmed plan and a conversion to Chapter 7 bankruptcy.

Keeping Expenses Reasonable

When it comes to expenses, venue makes a huge difference. Travel costs for lead counsel, accessibility of the forum by regular airline flights (Reno, anyone?), rules requiring the retention of local counsel and the rate structure of lawyers in the jurisdiction are all important considerations. A court's willingness to handle hearings by proffers of evidence, instead of requiring lengthy witness testimony, and to conduct phone hearings on uncontested matters can also affect the bottom line significantly. For a midmarket client with \$25 million in debt, the Southern District of New York might have favorable rules, but the rate structure of competent lawyers there could make any Chapter 11 short-lived.

For the restructuring professionals involved in the case, knowing that a jurisdiction is reasonable about fee approval and receptive to out-of-town market rates and expertise is paramount. One Mississippi jurisdiction, for example, is known to cap Chapter 11 "reasonable" attorney rates at \$275 an hour, a fee structure far below market rate for experienced bankruptcy lawyers in any other district.

Disposing the DIP Lender

Everyone knows companies need money to reorganize. That's why the approval of a debtor-in-possession (DIP) lender, which extends credit to companies in Chapter 11, often overrides other venue concerns. The DIP lender's considerations include the likelihood that the DIP loan will be approved as negotiated; the reasonableness of any carve-outs the court imposes; whether the court will enforce the DIP loan if the debtor defaults; the ability to roll up the company's pre-bankruptcy debt; and the DIP lender's ability to get its own fees approved at reasonable levels.

Because the DIP lender holds the cash, it generally makes the rules about where to file the case. Many are the cases that were prepared for one venue, only to be changed at the last minute to accommodate a newfound DIP lender's demands.

Making Venues Work for You

With all the venue options for bankruptcy filing at a company's disposal, choosing the right place to reorganize can be daunting. But maximizing predictability by thoroughly researching all the aspects of a particular venue can go a long way toward the success of a company's restructuring, as well as its future.

Bobby Guy is a member of Frost Brown Todd LLC and works from the law firm's Nashville, Tenn., office. He specializes in returning struggling companies to profitability and helping companies and funds buy distressed assets. He is listed in Best Lawyers® in America, Super Lawyers® and the American Board of Certification's list of business bankruptcy lawyers. He can be reached at bguy@fbtlaw.com or (615) 251-5557.

Promotions at MorrisAnderson



Aaron Gillum has been promoted to the position of consulting manager with MorrisAnderson. Gillum joined MorrisAnderson's Chicago office as a consultant in 2008, and has provided financial and strategic management to businesses in manufacturing, telecommunications, retail, government, health care and financial services.



Jason Paru has been promoted to the position of consulting manager with MorrisAnderson. Paru, who joined MorrisAnderson's Chicago office as a consultant in 2008, has provided financial and strategic management to businesses in manufacturing, consumer products, business services, distribution, retail, telecommunications, textiles and pharmaceuticals.

Moves at MorrisAnderson



Ed Bidanset has moved to MorrisAnderson's Atlanta office to help grow the firm's Southeastern U.S. practice. Bidanset, a consulting manager with MorrisAnderson who was formerly based in Chicago, will be working closely in his new role with Mike Musso, vice president of strategic accounts for MorrisAnderson.

Member of MorrisAnderson Affiliate Speaks at Bankruptcy Forum



Matt Darin of Frontline Real Estate Partners, an affiliate of MorrisAnderson, was a featured speaker during the Kansas City, Mo., 30th Annual Midwestern Bankruptcy Institute & Consumer Forum. Darin shared his views during "Real Estate Organizations: Hot Issues in Distressed Real Estate Deals."

New Website

MorrisAnderson has launched a new website designed to quickly and clearly inform visitors about our areas of expertise and successful track record. Visitors to the website can find the latest news on our engagements, detailed descriptions of our work process, information on our nine core focus areas and specific examples of the results we have achieved for our clients.

MorrisAnderson Signs Affiliation Agreement with Illumina Partners of Canada

MorrisAnderson has established its first international office through its affiliation with Toronto's Illumina Partners, a milestone in the continued effort to expand our geographic reach, pool of professionals and network of referral sources to better serve existing and prospective clients. Illumina Partners, a financial advisory firm founded in 2002, has a proven track record in corporate recoveries, turnarounds and restructurings, and operational performance management. The company's leaders possess more than 55 years of combined experience in the financial advisory field, and have managed more than CAD \$16 billion (U.S. \$16 billion) in transactions. The agreement will enhance business and referral opportunities and geographic coverage for both firms.



Upkar Arora



Kristy Bertrand



Jim K. Wilson

TMA Atlanta Chapter Honors MorrisAnderson with Turnaround Award

MorrisAnderson's work with Cosmolab Inc. has earned the firm the "Turnaround of the Year— Small Company" award from the Turnaround Management Association's Atlanta chapter. MorrisAnderson managing directors Michael J. Musso and Steven F. Agran led the turnaround of Cosmolab, a 100-year-old manufacturer of color cosmetic and skincare products based in Lewisburg, Tenn. Musso served as chief restructuring officer and interim CEO of the company throughout the turnaround process, while Agran served as primary financial advisor. The team developed a multifaceted plan to guide Cosmolab back to profitability, and then sold the company through a 363 sale, keeping Cosmolab in Lewisburg and saving 400 local jobs.

MorrisAnderson Recent Engagements



Automotive

Acted as financial advisor in the turnaround of an automotive financing business.



Consumer Products

Due diligence of operations and performance improvement for a \$100-million dress manufacturer and retailer.

Acted as financial advisor for a \$30-million garden products company.



Franchise

Acted as financial advisor in the wind-down of a \$25-million franchise restaurant operation.

Provided investment banking expertise in the liquidation of a \$24-million franchise operation.



Metals

Acted as financial advisor in the turnaround of a \$50-million construction materials distributor.

Acted as financial advisor for a steel fabricator.



Real Estate

Involved in the turnaround of a shopping center.

Provided financial advice and investment banking expertise to improve the performance of a parking management company.

Assisted in the wind-down of a commercial real estate business.



Other Industries

Provided financial advice to improve the performance of a \$120-million assisted living management company.

Acted as financial advisor for an \$85-million paper mill.

Involved in the turnaround of a \$60-million hotel furniture and equipment business.

Represented the credit committee of a \$20-million furniture manufacturer.

Acted as financial advisor for a seminary education business.

Acted as financial advisor and represented the creditor committee for Admiral Wine & Liquor, a wine and liquor distributor.

Acted as financial advisor for a construction crane rental company.

Recent Success Stories

Out-of-Court Restructuring

Restructured \$70 million in debt with five lenders for a 92-unit Southeastern multistate franchisee of a national brand.

Acted as interim manager and financial advisor in the restructuring of debt for a \$50-million scented candle manufacturer.

Assisted in refinancing debt and completing the partial sale of a \$60-million underground utility locating service.

Going Concern Sales

Acted as chief restructuring officer for Santa Fe Cattle Co., a \$60-million, 27-unit operation, and guided the company through a 363 sale.

Management Negotiations

Assisted the board of directors of a \$50-million direct mail marketing business in negotiating fair compensation packages for the company's management team as part of a turnaround.

Liquidations

Acted as financial advisor in the out-of-court liquidation of a \$50-million steel processor.

Liquidating Trustee

Assisted in resolving large claim litigation against Deltak, which provided large utility construction services, which will result in an increase of creditor recoveries to more than 70 cents on the dollar from less than 30 cents on the dollar.

Restructuring in Canada: Same Objective, Different Approach

By Upkar Arora, Chartered Accountant, Illumina Partners, Canada



Upkar Arora

No two turnarounds are alike, and the differences are more pronounced when comparing turnarounds in different countries. While Canada and America's insolvency industries share some similarities, Canada's restructuring practices feature concepts foreign to the U.S. system, including the role of a

court-appointed monitor. In addition, Canada has weathered the global recession more successfully than its southern neighbor, though some economic threats to Canadian industries continue to loom. Understanding these economic and legal differences is critical for businesses and debtors navigating Canadian or cross-border restructurings.

Two principal statutes govern insolvency proceedings for corporations in Canada — the Bankruptcy and Insolvency Act ("BIA") for smaller companies, and the Companies' Creditors Arrangement Act ("CCAA") for bigger companies. BIA allows companies to liquidate, much like the U.S.' Chapter 7 proceedings. Under BIA, an insolvent debtor can also file a plan of compromise or arrangement, or reorganize through a private- or court-supervised trustee. CCAA is more like the U.S.' Chapter 11 process, since both enable a business to continue operating while restructuring its financial affairs. CCAA typically applies to companies with more than \$5 million in annual sales or a multinational presence. Recent amendments to BIA and CCAA encourage the restructuring of viable businesses as an alternative to bankruptcy, a debtor-friendly move that comes not long after the United States became less debtor-friendly with the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act.

Overall, BIA and CCAA filings steadily declined in 2010, mirroring the United States' insolvency industry slowdown. In the latest report released by Canada's Office of the Superintendent of Bankruptcy (OSB), the number of business insolvencies filed under BIA in third quarter 2010 declined 18 percent from the previous quarter and 27 percent from the comparable quarter in 2009. For the 12-month period ending Sept. 30, 2010, BIA business insolvencies fell by 21 percent compared with the previous 12-month period. CCAA filings were even rarer, with just two filed in third quarter 2010, down from nine in second quarter 2010, 16 in first quarter 2010 and 14 in fourth quarter 2009. The slowdown in insolvencies stretches across many Canadian industries, including transportation, warehousing, retail trade, manufacturing, construction, agriculture and forestry.

While insolvencies have tapered off in both countries, Canada has fared much better in the global recession than the United States, its most significant trading partner. This is partly due to China's and India's continued demand for Canada's plentiful natural resources. By most measures, Canada's economy is relatively robust: interest rates remain low; inflation pressures remain weak; government budgetary deficits are small; GDP growth projections for 2011 remain in the 2.2 percent to 2.9 percent range; the unemployment rate is at 7.6 percent, its lowest point in almost two years; Canada's banks have vaulted up the rankings of the world's top banks; and the Toronto Stock Exchange Composite Index hit a two-year high in December 2010, reaching almost 13,400.

Yet the economic picture is not completely rosy. Just as in the United States, Canada's automotive and manufacturing industries have taken devastating economic blows. Household debt levels are high, clocking in at \$1.48 in debt for every Canadian dollar in disposable income, according to a December 2010 Bank of Canada report. That level exceeds even the United States', and will likely dampen consumer-driven growth. In addition, interest rate increases may result in higher default rates on residential mortgages; health costs continue to escalate well above the rate of inflation, causing budgeting headaches for governments; and Canada remains over-dependent on the U.S. economy. These troubling signs on the horizon may affect the insolvency industry in the years to come.

A Unique Process

For businesses that enter insolvency, the process they face differs significantly in Canada versus the United States. One of the unique aspects of the Canadian process is the existence and role of a monitor, a concept foreign to the U.S. system. The monitor does not replace the debtor's management team, and its role differs from the traditional chief restructuring officer (CRO), advisor and trustee roles often seen in U.S. bankruptcy and insolvency proceedings, although the monitor often fulfills aspects of each of these roles. Monitors are appointed to oversee CCAA filings, and while the role is open to some interpretation, the monitor's basic function is to observe the company's business and financial affairs to make sure it is following the law, court orders and its plan of reorganization. The monitor's duties include assisting the company with preparing a plan of reorganization, preparing court reports, providing information to creditors regarding the claims process and creditors meetings, and overseeing voting at creditors meetings.



It is important to understand the differences between Canadian and American insolvency approaches and the nuances that shape a country's restructuring process if **the goal is to achieve an effective outcome.**

The monitor is an officer of the court — not an advisor to the company — and the court may expand the monitor's duties. The monitor must be a licensed trustee, and recent changes to the law forbid a company's auditor from acting as the monitor during bankruptcy proceedings without explicit court approval. This is a significant change from previous years, when a company's auditor became the monitor in a CCAA proceeding more often than not, despite what a cynic would say was an obvious conflict of interest.

The monitor oversees the performance and activities of the debtor's management team from an unbiased perspective, and provides substantive information to the court regarding the financial position and cash flows of the debtor, the disposition of assets and the plan of reorganization's elements. Courts rarely go against the monitor's recommendations, making it advantageous for debtors to cooperate with their monitors.

Though most creditors and advisors do not have issues with the legal construct of a monitor, the monitor's role, in practice, gives some creditors and advisors indigestion. Due to the court's time constraints, need to access information about the debtor and interest in expediting the bankruptcy process, the monitor's role often grows to include other duties. Monitors can be negotiators, plan implementers and financial advisors, and courts rely heavily on the information they provide. For others in the insolvency processes, this can raise many concerns. Among them:

- Can monitors maintain their independence and objectivity or do they become too aligned with debtor management?
- Does the monitor's role conflict with or duplicate the work of a CRO?
- Can the monitor balance the needs of multiple constituents, instead of focusing primarily on a typical trustee's role of maximizing realization for the benefit of creditors?
- Is it a conflict of interest when the monitor acts in other capacities?

The CRO's Role

The solution to these issues is not to codify or narrow the role for the monitor, but to ensure the debtor has an effective CRO, an independent professional who facilitates the turnaround process. The monitor's role can expand or contract based on the size of the informational and directional void created by the debtor on filing, and the CRO's ability to diminish that void. The CRO performs several important tasks — bridging the information gap, assessing the debtor's financial and operational performance, contributing and expediting the plan of reorganization, and evaluating the effects of a plan on multiple constituents. With an operations and business-focused skill set, the CRO brings an orientation and value distinct from the monitor's trustee background.

Hiring a CRO ideally takes place before a company's bankruptcy filing, making the CRO the most knowledgeable party at the time of the filing on the business' financial position, cash flows, restructuring alternatives and status of various cost-reduction or sale initiatives. CROs can effectively manage cases that involve fraud, misallocation of fiduciary funds or other criminal activities, and can also guide a company through a sale process where the owners or the management team are prospective bidders. In addition, CROs can negotiate material transactions, avoiding the conflicts of interest that can arise when monitors do so. Finally, CROs can provide expert testimony on the debtor's behalf and represent the debtor in court hearings. While an effective CRO will never eliminate the need for a monitor, the CRO can reduce the areas in which the monitor is obliged to take an active leadership role.

It is important to understand the differences between Canadian and American insolvency approaches and the nuances that shape a country's restructuring process if the goal is to achieve an effective outcome. Those differences reinforce the value that a capable CRO or advisory firm — especially one that has the knowledge and experience of working in both jurisdictions — can provide to achieve a successful restructuring in a cost-effective and expeditious manner.

MorrisAnderson Ranks Among Top Crisis Management Firms

Many businesses that seek to restructure turn to MorrisAnderson for its expertise — and the numbers prove it. MorrisAnderson's caseload ranks among the top 10 crisis management firms in the country, according to the latest figures from The Deal LLC, which tracks insolvency industry trends. MorrisAnderson continues to leverage its position in the industry to provide clients with the best value.

Rank: 7

Number of cases: 36

Cases based in the United States: 100 percent

**Includes all debtor, creditor and other assignments within active bankruptcy cases. All cases active as of Sept. 30, 2010.*

Source: The Deal LLC.

An Inside Look at the Coming Year



Ken Yager



Matt Darin

MorrisAnderson principal Ken Yager moderated a Turnaround Management Association webinar in January that offers an in-depth look at the industry and economic forecast for 2011. The hourlong session discusses how current economic trends will affect the turnaround and corporate restructuring world and what firms can do to prepare for the coming year. The discussion panel also includes Matt Darin of Frontline Real Estate Partners, a MorrisAnderson affiliate. The webinar is archived and available for purchase under the TMAccess section on www.turnaround.org.

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