Business Bankruptcy Committee Newsletter

"Business Bankruptcy Committee: The World's Largest Organization of Bankruptcy Restructuring Lawyers"

The Business Bankruptcy Committee looks forward to seeing you at the ABA Business Law Section Spring Meeting in Boston, Massachusetts on March 26 through March 28, 2020. We have a dynamite lineup of interesting and informative programs for bankruptcy and business law practitioners. In the Spring newsletter, we will highlight all of the program and events sponsored by the Business Bankruptcy Committee. We hope to see you in Boston!

We are thrilled to share with you that Celeste Boeri Pozo is the Winner of the Business Law Section’s 2019 Kathryn R. Heidt Memorial Award! This edition includes two excellent articles: one from Salene Mazur Kraemer, Esq., MBA, CTA-A, entitled “The Dark Side of Business Bankruptcy: 10 Practice Pointers for the Restructuring Professional”; and the other from Patrick McKnight, entitled “Is Bankruptcy Protection Coming for the Cannabis Industry?”.

We are also excited to continue our spotlight series, this time with an interview with Bruce Borrus of Fox Rothschild LLP.

Note from Susan Freeman:
I hope many of our Committee members will be able to join us at the Spring Meeting in Boston next month. Our next eNewsletter will describe our excellent bankruptcy programs in more detail. Please go ahead and register and make your travel plans: https://www.americanbar.org/groups/business_law/events_cle/spring_2020/. Here’s a link to the program schedule – you’ll find ours under Business Bankruptcy: https://www.americanbar.org/content/dam/aba/events/business_law/2020/03/spring/alpha_schedule.pdf.

Let me also encourage you to nominate a young bankruptcy lawyer you know – including those who are not already members of the Business Bankruptcy Committee – for our 20/20 Partners Rising Young Leaders Award by the July 1, 2020 deadline. Our goal is to recognize emerging leaders in our practice, and to encourage them to get involved in the ABA and take advantage of all the educational and leadership opportunities the ABA offers. On October 14, 2020, at the Committee’s meeting in conjunction with the NCBJ in San Diego, California, we will recognize 20 young lawyers who show promise to be future leaders within the legal profession, the ABA and the Business Bankruptcy Committee. Nominees must have been practicing five years or less as of the June 30, 2020 nomination deadline, i.e. admitted to the bar for the first time on July 1, 2015 or later. The process is easy; here’s the link: online nomination form. If you qualify as a young lawyer yourself, please consider self-nominating.
Celeste Boeri Pozo, Lead Counsel at the Inter-American Investment Corporation (IDB Invest) in Washington, D.C. and former counsel at Hughes Hubbard & Reed, is the winner of the prestigious 2019 Kathryn R. Heidt Memorial Award presented by the Business Bankruptcy Committee of the Business Law Section of the ABA. The Kathryn R. Heidt Memorial Award is given annually to a recipient under the age of 45 who has made a significant contribution to the ABA Business Bankruptcy Committee in terms of a written publication, has demonstrated leadership potential within the ABA or the larger legal community and has displayed generosity of spirit.

Celeste is an active member of the Uniform Commercial Code (“UCC”) Committee, serving as one of the Vice-Chairs of the Committee. She also served as Chair of the International Commercial Law Subcommittee of the UCC Committee and one of the editors of the BLS Commercial Law Newsletter. Celeste is the co-chair of the International Commercial Law Book Project and serves as lead co-editor. This book will be comprised of a collection of surveys comparing the laws of more than 30 jurisdictions around the globe concerning security interests in investment property and deposit accounts. In addition, Celeste has published numerous articles as well as participated on panels sponsored by the Business Bankruptcy Committee.

In addition to her work in the business legal community, Celeste has also dedicated her efforts to pro bono service by serving as a guardian ad litem for a young child through the Dade County Legal Aid, despite having limited courtroom experience as a transactional attorney. She also contributed her services pro bono to the Miami-Dade United Way Task Force. Celeste is, and will be continue to be, a leader in the ABA and is an extraordinary example of an attorney who has given back to her community through her generosity of spirit.
The practice of chapter 11 business bankruptcy law, can, at any given time, involve any of the following:


I have personally witnessed all but 2 of these.


I have practiced business bankruptcy for almost 20 years now. Yes, some days are dark. But 95% of the time I really enjoy the work. This is a fast-paced, hybrid practice (involving both transactional and litigation work). One can work with multiple parties toward efficient settlement. It is a privilege becoming the mastermind behind the restructuring of a business, outfitted with the unique ability to harness the tools of the Bankruptcy Code to help people, saving them from ruin, enabling employees to keep jobs, and principals to keep assets. A debtor’s attorney can be the hub of the reorganization wheel with the goal of persuading creditors to support a restructuring plan. At the helm of selling businesses and properties, you can become an important contributor to the engines of a local economy. I enjoy this practice area so much I actually recently become Board-Certified by the American Board of Certification in Business Bankruptcy.
The purpose of this article is to address the dark side of the business bankruptcy practice and how to better deal with it.

First, as a chapter 11 debtor’s attorney, a challenging issue can be getting paid. As a solo or managing partner, not only do you have to do the legal work but you have to manage an office and be a bill collector. Each debtor case can be riddled with risk for any firm, big or small, given a client’s poor cash position. Some clients may try to unilaterally convert your hourly structure to a contingent arrangement because he or she didn’t like a Court’s outcome through no fault of yours. Desperate, debtors may decide to only pay expenses that are absolutely necessary to corporate existence. Secured creditors may have liens on all of your client’s cash, and block access to that money for legal fees. If you are not careful, your firm may become the debtor’s creditor too! If your firm is owed money as of the filing of the bankruptcy case, you may be disqualified from representing the debtor unless your firm agrees to waive the claim for fees.

Second, building a book of repeat businesses over time can be challenging for debtor practitioners because the goal of a good debtor’s lawyer is to make sure your client never needs you again for bankruptcy purposes.

Third, bankruptcy lawyers sometimes deal with people who are at their absolute worst and/or are criminal in nature. Given guilt, pride, and likely personal guarantees of business debt, the filing of a chapter 11 for a business owner may be the worst day of his or her life with personal assets and long-term relationships on the line. Yet these clients have fiduciary duties to creditors. We often resolve serious financial problems with warring factions (i.e., lenders, employees, taxing bodies, judgment creditors, pension funds, suppliers, customers, etc.); a hostile and prolonged battle can cause inordinate stress, mounting legal fees, and emotional turmoils for principals and executives. Temptations to divert funds are real and require vigilance by debtor’s counsel. Addictions can flare and mental illnesses can be exacerbated. I have seen spouses leave the executive. I have seen parties march right into open-heart surgery. A former client committed suicide.

Per United States Bankruptcy law, businesses are entitled to reorganize and move forward—equivalent to an individual debtor’s “fresh start,” with “breathing room” to reset. In my 20 years of experience, I know now that not all businesses deserve that “fresh start.” Some businesses abuse the system, repeatedly filing chapter 11 to avoid legitimate debts, the non-payment of which sometimes places suppliers/vendors themselves in serious financial distress. Others commit bankruptcy crimes and the owners are jailed as a result. Perhaps management has perpetrated fraudulent schemes, “accidently” underreported income, “inadvertently” hidden assets, or just “forgot” to tell you key facts. In the field of business bankruptcy, assuming that all people are good and fair is a faulty assumption. The practice can be downright dangerous. You cannot aid your client’s wrongdoing, and your duties to the court require a jaundiced eye and diligent inquiry.

One of my former bosses told me one of his debtors owed mafia money; the creditor showed up at his 341 meeting of creditors and the debtor was never seen or heard from again.

Here are my top 10 things a practitioner should do to protect oneself and one’s firm:

1. Filter Out Bad Actors in the Initial Client Interview.

Never take a case without ferreting out a client in person and doing a google search on the business and principals. Are there alias names? Conduct title searches and adverse filing checks to make sure the story of the demise of the business adds up. Watch out if you are filing on an emergency basis and may not have time to do this.
2. Set the Tone Regarding Payment.

When you know you have your client’s attention, be very clear from the get-go that you will ask the court to authorize you to stop work if your compensation is at risk, including maintenance of a sufficient retainer. Has the secured bank consented to the use of its collateral to pay your fees? Will your fees be paid by a third party? If the client dances around the fee issue at the initial client meeting, or if you can tell there are insufficient unencumbered funds at the outset and/or projected income from operations to pay your fees, it may become a problem later.

Attorneys can explain that paying a significant retainer up front by a restructuring client can evidence the seriousness with which the client will take the endeavor and respect the value of your services. See Clients Who Don’t Pay: What Can Lawyers Do? By Andrew Abramowitz, PLLC, https://aalegalnyc.com/what-can-law-firms-do-about-the-trump-approach-to-paying-legal-bills/ (July 27, 2016).

When you are owed money, be persistent and personal in asking for court-approved fees to be paid, and request interim approval of fees on a timely basis. Be informed about how to record a judgment for any court-approved fees. The process may vary by jurisdiction. Be sure you know the terms of your malpractice insurance.

3. Diversify Your Client Base.

Diversify the work you do with creditor work or a completely unrelated legal practice. This will offset the risk of non-payment and give you breaks from all the stress you may be experiencing on your chapter 11 matters. I work on business matters for healthy companies and also Italian dual citizenship cases because I love Italy!

4. Avoid Substance Abuse; Find Outlets.

It is no secret that lawyering across the board can be a very difficult profession. Lawyers are 3.6 times as likely to be depressed as people in other jobs, while the landmark 2016 American Bar Association and Hazelden Betty Ford Foundation study found that 28 percent of licensed, employed lawyers suffer with depression. See Lawyers Weigh In: Why Is There a Depression Epidemic in the Profession? (May 11, 2018), by Dina Roth Port for the ABA Journal. The study also showed that 19 percent have symptoms of anxiety and 21 percent are problem drinkers. Id.

Most of us are type A perfectionists often dealing with overwhelming caseloads and clients in crisis while our adversaries are working as hard as they can to deconstruct our efforts. Tina Willis, founder of Tina Willis Law, personal injury firm in Orlando, Florida, writes, “Other than professional boxing, I can’t think of any other profession where the job requires constant fighting!” See Dina Roth Port for the ABA Journal, supra.

For me, I turn to hobbies to help manage the adversarial nature and uncertainty of the practice - swimming, skiing, yoga, biking, photography. What will be your non-legal escape?

5. *Be Very Clear with Client about Fiduciary Duty, Conflicts of Interest and Honest Disclosure; Keep a Paper Trail.*

At the initial client meeting and also throughout the engagement, be very clear about the importance of honest disclosure and that you will withdraw if you suspect the client is not telling the truth, breaching a fiduciary duty, and/or is dishonest or committing fraud. Warn that bankruptcy fraud is a crime and will land the client in jail. Make sure the client understands that you represent the client entity, not the individual owners. Send out letters to the client to document your trail of conversations regarding any suspected wrongdoings by the debtor. Keep extra copies of the letters and be sure emails are saved.

6. *Explore the Appointment of a Chapter 11 Trustee or a Conversion to a Chapter 7; Vigorously Review Proposed Plans of Reorganization and Projections.*

The Code provides for the mandatory appointment of a chapter 11 trustee in the event of certain wrongdoing by a debtor. A party in interest wishing to dispossess a debtor of management of its business and control over its estate must prove, by clear and convincing evidence, that appointment of a trustee (i) is warranted for "cause" under 11 U.S.C.S. § 1104(a)(1), or pursuant to 11 U.S.C.S. § 1104(a)(2), (ii) is in the best interest of creditors. *See In re Sillerman,* 605 B.R. 631, 641-44 (Bankr. S.D.N.Y. 2019). Section 1104(a)(1) enumerates four types of misconduct that constitute cause: fraud, dishonesty, incompetence and gross mismanagement. These examples are not exhaustive. *Id.* Examples of non-enumerated misconduct include: (i) failure to comply with provisions of the Bankruptcy Code; (ii) failure to make required filings; (iii) failure to abide by Court Orders; (iv) failure to file tax returns; (v) conflicts of interest; and (vi) failure to discharge fiduciary duties. *Id.* Your client needs to understand that your obligations to the court trump those to your client, so that you may not be able to resist such a motion if wrongdoing occurred.

Courts have found a breach of fiduciary duty where the debtor is submitting plans of reorganization that the debtor cannot fulfill and projecting financial performances that the debtor fails to obtain. *Id.* at 649-52. Debtor’s counsel should carefully subject a plan and projections to rigorous examination, disclosing risk factors and assumptions to the Court and creditors.

The appointment of a trustee or the conversion of the case may impair your firm’s ability to be paid, and the trustee will likely take over the client’s attorney-client privilege and have the right to access your files. Be prepared for this possibility at any given time and fully and formally inform the client of the consequences of the same.

7. *Be Mindful of Ethics Canons Requiring a Duty to Disclose; Monitor Client Health.*

Maybe you now know something you don’t want to know. Or, your client may not be competent enough to testify or meaningfully participate in the reorganization. He or she may not be reliable enough to provide statements. His or her ability to understand the consequences of the case may be impaired. Call your local bar’s Ethics Hotline for their guidance on how to handle the client’s mental crisis and how you as a professional should handle any suspicions of dishonesty or fraud. *See Mental Illness, Your Client and the Criminal Law,* by Texas Tech University School of Law, p. 7, https://www.texasappleseed.org/sites/default/files/Mental_Health_Handbook_Printed2015.pdf (February 2015 (4th ed.)).

The better able you are to walk away from any client at any given time, the better quality clients you will attract and retain. Be sure your engagement letter covers this, but also realize that once you appear in a case, you will need court permission to withdraw.

9. Don’t Get Too Personal with Clients until After Engagement is Over.

Clients in dire straits are human and may envy you, your family and your vacations and may resent paying you money. Also, you never know when your client may turn on you, switching loyalties. Watch out! Keep the relationship professional and arms-length, at least until the matter has concluded. Establish clear boundaries regarding when you will be able to be on the clock. After 7 p.m.? On the weekends? Do you give your client your cellphone number? Explain that robust conversations must be had over the phone or in person during weekday work hours. Period. For safety reasons, do not disclose personal home address or too much personal information to clients. One night, I could not sleep for fear that the former client would hurt us!

10. Remember You Didn’t Create the Facts, Your Client Did.

Clients may try to place blame on everyone (including you). They are down in the trenches and may want you to be pulled down there with them. Repeat to YOURSELF that you as the attorney had nothing to do with the facts of the case. You didn’t create them. You have been hired to identify what the client needs for the best outcome given that set of facts and given external factors over which you have no control (i.e., the case law precedent in that jurisdiction). Don’t make the client’s big problems your problems. See Dina Roth Port, for the ABA Journal, supra.

Despite the chaos and risk of chapter 11 practice, I view the work as a privilege. Business owners are relying on me to save their business and salvage their personal lives. For grateful clients, the work is extremely rewarding and can leave me with lifelong friends not to mention a now Reorganized Debtor who needs a business attorney.
The U.S. legal cannabis industry is continuing its remarkable growth. Due mainly to legal reforms at the state level, 2019 legal cannabis sales are expected to generate over $10 billion in revenue. Products ranging from buds, oils, and tinctures are increasingly being used medicinally to treat chronic pain, cancer, terminal illness, and some stress-related mental disorders. Recreational use is becoming legal in a growing number of states.

**Bankruptcy and the CSA**

Thirty-three states have enacted some type of medical marijuana program. Eleven states have legalized the recreational adult-use of marijuana. Some industry analysts project revenue from legal cannabis sales will double over the next five years as more states seem poised to follow the trend towards cannabis reform.

Change at the federal level has remained elusive. Federal bankruptcy protection for business-debtors involved in the sale of cannabis products has not been forthcoming. The Federal Controlled Substances Act 21 U.S.C. §§801-904 (“the CSA”) remains a complete bar to any Chapter 11 protection.

Compliance with state laws is of little benefit when it comes to federal bankruptcy, banking, and tax codes. Cannabis start-ups are entering a potentially lucrative but risky new industry. Debtor-clients operate beneath this challenging additional layer of legal complexity.


This exclusion may have secondary impacts beyond the business owners themselves. Investors and creditors should take the lack of federal bankruptcy protection into account before deciding whether to contribute financially towards such an unprotected industry.

The U.S Trustee has consistently argued successfully that federal bankruptcy cases are inappropriate for businesses connected to the cannabis industry. Maintaining claims which involve conduct in violation of federal law would require a federal court placing an implicit stamp of approval on prohibited activity. The Department of Justice has likewise taken a hard stance against bankruptcy protection. Bankruptcy courts have agreed.
Is Change on the Horizon?

Some bankruptcy attorneys believe a May 2019 decision from the Ninth Circuit suggests the status quo may be changing. *Garvin v. Cook Investments NW* involved several real estate holding companies filing Chapter 11 in Washington State. One of these debtors leased land to a business which used the land to grow cannabis. The cannabis business-lessee was apparently in compliance with all applicable Washington State laws and regulations.

The U.S Trustee objected to the debtor’s plan even though it included payment of all creditors. The Trustee was concerned the debtor’s plan involved continuing to accept rent from the cannabis business. The Trustee argued confirmation of the plan was disallowed under the language of §1129(a)(3), “[t]he court shall confirm a plan only if all of the following requirements are met ... [t]he plan has been proposed in good faith and not by any means forbidden by law.”

The Ninth Circuit Court of Appeals ruled against the Trustee. According to the Court of Appeal’s interpretation, §1129(a)(3) “directs bankruptcy courts to police the means of a reorganization plan’s proposal, not its substantive provisions.” In other words, because the plan itself wasn’t made in an illegal manner such as fraud or duress, the Trustee could not rely on §1129(a)(3) to object to its underlying details. The Court of Appeals reiterated its holding was limited to procedural and not substantive standards.

Despite making some initial headlines, *Garvin* remains the exception rather than the rule. In fact, just two weeks later a Michigan Bankruptcy court reached the opposite conclusion in a case involving similar facts. In *In re Basrah Custom Design*, 2019 WL 2202742 (Bankr. E.D. Mich. May 21, 2019), the court dismissed a case filed by a debtor corporation whose operations centered around manufacturing wooden furniture. The debtor also leased some property to a medical marijuana dispensary operating legally under Michigan law. The bankruptcy court dismissed the case but hinted it might have reached a different conclusion if the debtor had ceased any connection with the marijuana-related business.

**Conclusion**

Studies indicates that across the U.S economy 80-90% of new businesses will fail. Given the rapid rate of business formation in the cannabis industry, many of these “cannapreneur” start-ups run the risk of failing to qualify for Chapter 11 protection. As the cases make clear, it’s not only growers and dispensaries who need to be concerned. Any debtor doing business with a cannabis business may also putting themselves themselves at risk. This can include everyone from landlords to vendors.

The cannabis industry may be the largest sector of the economy currently operating without the benefit of Chapter 11 protection. The incongruity between the evolution of state-level cannabis laws and the ongoing prohibition at the federal level raises a number of interesting legal questions. Federalism questions also arise involving compliance with federal banking and tax laws.

While many of these questions have merit, bankruptcy courts cannot be expected to function as the appropriate venue. Clients and other stakeholders shouldn’t expect a change in the status quo any time soon. While the reward of capturing an early-mover advantage in a rapidly growing industry may prove irresistible, businesses are well-advised to remain mindful of the potential risks.
We are pleased to announce that this quarter’s Member Spotlight is Bruce Borrus.