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HYDRA Professionals LLC

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Business In Crisis: After Week One

In the article, *"Business in Crisis: Week One,"* the initial focus of a business in crisis is on short-term survival, obtaining a preliminary, broad understanding of the stakeholders, and implementing key processes and controls.

The major milestones triggering the exit from "week one" activities are:

- Stabilizing funding to allow resumption of revenue producing activities for a period of one to four weeks.
- Communicating with all stakeholders regarding the current situation and the near-term (1-4 week) action plan, and agreeing on the near-term support to be provided by the respective stakeholders.
- Putting cash and other controls in place to (a) manage commitments to stakeholders, (b) protect stakeholders from further deterioration of their position for the benefit of another stakeholder similarly positioned, (c) obtain the goods and services needed to maintain production, and (d) manage cash receipts and disbursements on a daily basis consistent with the cash flow forecast.

The breathing room obtained by completing the above activities allows the Company and its professionals, legal counsel and turnaround specialists to focus on the following:

- Financial forecasting and analysis
- Stakeholder assessment
- Viability assessment
- On-going activities

Financial Forecasting and Analysis

Once the immediate cash needs have been addressed, there will be an opportunity to look at a longer time frame. Typically this time frame is 13 weeks. To demonstrate that the Company can continue operating at cash breakeven during this period, the preparation of a 13-week cash flow forecast is critical to allow time to develop and implement a long-term strategy, and stakeholders may be willing to work with the Company by providing certain concessions or support. Creditors, for example, may offer continued lending if their position does not deteriorate over the 13-week period. Customers may be willing to provide interim support such as accelerated payments to ensure that their product flow is not disrupted.

If the stakeholders are being asked for assistance, it is important to understand their priority and security positions, and the amounts they have at risk at this time. A detailed review and reconciliation should be done for creditor accounts, including vendors, where significant liabilities exist. To protect the interests of creditors, all creditors of similar position should be treated equally during this 13-week period. Many creditors and suppliers will not provide support or continue delivery of products or services if they feel they are being treated unfairly (i.e., if similar creditors are improving their position at the expense of others).

By preparing a thorough liquidation analysis, the extent to which the secured creditors are secured, partially secured or under-secured in orderly and forced wind-down scenarios becomes apparent. This understanding is key to determining what priority each type of creditor has, if any, the possibility and extent to which creditors can expect repayment, and provides useful negotiating information, including assessing whether filing for bankruptcy may be necessary. Recent appraisals, if available, can provide orderly and forced liquidation values of hard assets, while other analyses are required for valuing current assets and intellectual property.

Stakeholder Assessment

Understanding the true needs and interests of stakeholders is an iterative and critical process. As stakeholders become more knowledgeable of the risks and impact of the current situation on their interests, their needs and interests will most likely change. If a customer discovers the business has valuable intellectual property required for the production or sale of a particular product, this could increase the cost or ability to resource production and, correspondingly, increase the customer's interest in keeping the supplier and possibly providing some sort of support.

If creditors are comfortable that their positions will not deteriorate, they may be willing to

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Letter from the President

Grant T. Stein
Alston & Bird LLP

This is my final column as President of the AIRA. I took a look at my articles over the past two years and confirmed what I remembered – it has been an unprecedented time in our business. From Baer Stearns to Lehman and AIG, Chrysler, GM, the takeovers of Freddie Mac and Fannie Mae, Washington Mutual and the sale of Wachovia to Wells Fargo, Bernie Madoff, and so many other significant cases and economic developments focused on our profession and the issues with which we deal regularly in these irregular and unusual cases. And, these examples are primarily in the United States. Internationally, it has not been an easy time either and that is having current impact here in the U.S. Of course, the impact on the regional and national economy of the oil spill in the Gulf has not fully been felt yet. Whether you are or were involved in the mega-cases, or work in the middle market, you were required to use all the skills and creativity at your disposal to find solutions to the most trying economic environment in seventy years.

If you take at look at the hard work of Grant Newton, the AIRA Executive Director, Jack Williams, our Scholar in Residence, the entire AIRA Staff, and all of our volunteers on our Board and the Co-Chairs and Planning Committee Members for our Annual Seminars, VALCON, and webinars, all of whom have enthusiastically invested their time and intellect to provide cutting edge, high quality, and diverse educational programs, you will see an organization that is working hard to meet its responsibility to its members. We work hard not to trot out the same old thing unless the same old thing is measured by quality, in depth, business focused, practical, presentations.

The substantive quality of the AIRA is what drew me to it in the first instance many years ago. The very first program with which I was involved for the old AIA back in approximately 1991 was on valuation, and even at that early time, the depth and diversity of disciplines that were presented spoke well of the educational bent of the organization. That reputation is in evidence every time we engage in the training function, and it is one in which we all take a great deal of pride.

Thank you for the support you have given the AIRA over the past two years. I wish our next President, Stephen Darr, the very best as he continues and expands the role of the AIRA in our profession.

Grant T. Stein

Grant Stein is a partner in Alston & Bird's Bankruptcy, Reorganization and Workouts Group. His diverse practice includes the representation of debtors, secured and unsecured creditors, creditors' committees, and fiduciaries in complex and difficult out-of-court workouts, debt restructurings, bankruptcy cases, and financial transactions throughout the United States and internationally. He also regularly represents officers, directors, and other parties in bankruptcy litigation of all kinds. His restructuring experience includes manufacturing, real estate, wholesale, retail, distribution companies, health care, communications, technology and intellectual property issues.

AIRA's Scholar in Residence

Professor Jack F. Williams, CIRA/CDBV
Georgia State University

BANKRUPTCY RETAKES

Ponzi Schemes: Part I

Our world is changing dramatically. So is our practice. Many of us are finding that our practice is leading to the investigation and prosecution of a virulent form of fraud – the Ponzi scheme. In a series of articles, I want to introduce you to the infinite variety of Ponzi schemes and the currency at which they trade, that is, trust and greed. This column begins with a little history about the scheme that birthed the name Ponzi.

Black's Law Dictionary defines a Ponzi scheme as:

A fraudulent investment in which money contributed by later investors generates artificially high dividends for the original investors, whose example attracts even larger investments. Money from the new investors is used directly to repay or pay interest to old investors, without any operation or revenue producing activity other than the continual raising of new funds. This scheme takes its name from Charles Ponzi, who in the late 1920s was convicted for fraudulent schemes he conducted in Boston.

In 1920, Carlo "Charles" Ponzi sent one dollar to his cousin in Italy. The cousin exchanged the dollar for 22 Lire and bought 66 postal reply coupons which were sold by the United States Postal Service at a fixed exchange rate. The coupons were then sent to Ponzi who redeemed them for five cents each, for a total of $3.30. Ponzi then sold the stamps to a single customer at a ten percent discount. The gross profit totaled $1.47, after a one dollar investment, 50% interest, and a 10% discount to the customer. Ponzi had earned a gross profit of 230%. Pitching his "fund" as capitalizing on the fixed exchange rate offered by the Postal Service, Ponzi's scheme began.

Ponzi hired a bookkeeper, retained a lawyer, opened 30 offices, and hired sales agents. In February of 1920 Ponzi sold $5,000 worth of notes to investors and by April had sold $53,000 in notes. In May he sold $500,000 in notes and by the summer was raising $1 million a week. The single best day involved 30,000 investors. By that July Ponzi owed $15 million. Ponzi kept money in banks and had trash cans full of money stacked in his office. At one point, Ponzi had $7 million in cash. During this period, Ponzi purchased 25% of a bank, a macaroni company, and a construction company.

On July 26, 1920, the Post ran a front page story about Ponzi. Clarence Barron wrote that a check with Universal Postal Union revealed that there were only a few hundred thousand dollars worth of stamps in circulation. Ponzi could not possibly have been selling the millions of stamps which he claimed to be selling. Barron also noted that the United States Postal Service would not redeem more than 10 reply coupons at once. Clarence Barron saw that "Right under the eyes of our government court officials, Mr. Ponzi has been paying out U.S. Money to one line with deposits made by a succeeding line." The damage caused by this article was instantaneously apparent. Hoping to prevent a run on his company, in August of 1920, Ponzi began offering refunds. Thousands of investors lined up for the refunds and millions of dollars were paid out.

The run brought Ponzi's scheme crashing down. To maintain equilibrium, each month required double the amount of total previous investment. People's greed and frenzied investment driven by word of mouth drove the necessary exponential growth rate. Without these two factors, the pace of investment could not be maintained.

Following the run, a panel of three Receivers was established and Ponzi declared bankruptcy. The Receivers sued for the $7.5 million in refunds as preferential transfers. The preference case was heard by the United States Supreme Court. Allowed claims totaled $6.4 million from 10,550 investors. The case took seven years to unwind. The initial distribution of 10% took place in December, 1921. The final distribution of 37% was made in December of 1928.

Next column walks us through the characteristics of a Ponzi scheme. ■

Executive Director's Column

Grant Newton, CIRA
AIRA Executive Director

In many ways AIRA's 26th Annual Bankruptcy and Restructuring Conference takes place at a pivotal crossroads—a time to analyze and share collective intelligence on the months behind and before us. The Greeks used the term *kairos* for a critical point with special significance for a community: This must certainly be such a moment for the community of professionals in bankruptcy and restructuring.

In light of the recent passage of the new health care bill we are especially pleased to have **Senator William Frist** as the keynote speaker at the Annual Banquet. Eighteenth Majority Leader of the U.S. Senate (2003-2007) and distinguished professor at Vanderbilt Owen Graduate School of Management, Senator Frist earned international respect as a leader in heart and lung transplant surgery before seeking public office. His perspective on health care and answers to audience questions should be intriguing.

On Thursday morning, the conference will be opened by **Fred Crawford**, CEO of AlixPartners, who will take the podium to elucidate the concept of "New Normal." Friday's morning program will feature **Roger J. Grabowski**, Managing Director of Duff & Phelps, co-author (with Shannon Pratt) of *Cost of Capital* and *Cost of Capital in Litigation* (new edition to be released this year). He has selected a vital topic—"State of the Markets and the Continuing Impact on Distress: Illiquidity in a Market with Limited Activity and Little Transparency."

Lunch on Friday will be another high point when **Dr. Valerie Ramey**, Professor of Economics at University of California San Diego, addresses Business Cycle Stabilization and Long Term Fiscal Outlook, including the impact of government spending multipliers. **Professor Jack Williams**, AIRA's Resident Scholar (Managing Director, BDO Consulting and Professor at Georgia State University College of Law and Middle East Institute) will elucidate "Financing of Undercapitalized Firms in Emerging Markets" at Wednesday's luncheon.

The Planning Committee has developed an outstanding program for the 26th Annual Conference, including many pressing topics such as Distressed M&A Market Trends; "When Will the Boardwalk Return?"–Retail Trends; "Shell Games"–Ponzi Scheme Cases; Litigation in Midst of Financial Crisis; Distressed Investing; "Tsunami or Ripple: The Distressed Real Estate Wave." Also, this is our third conference with a special track for the small business/middle market area, including a presentation **by Victor Owens** (Union Bank) on strategies for fiduciary deposits, among others.

See you in San Diego,

Grant

Grant W. Newton, CIRA
Executive Director

Jerman v. Carlisle

Baxter Dunaway

Supreme Court of the United States

Karen L. JERMAN, Petitioner,
v.
CARLISLE, McNELLIE, RINI, KRAMER & ULRICH LPA, et al.

No. 08-1200.

Argued Jan. 13, 2010.

Decided April 21, 2010.

Background: Debtor brought action against debt collector, alleging violations of the federal Fair Debt Collection Practices Act (FDCPA) and the Ohio Consumer Sales Practices Act (OCSPA). The United States District Court for the Northern District of Ohio, Patricia A. Gaughan, J., 502 F.Supp.2d 686, granted debt collector's motion for summary judgment. Debtor appealed. The United States Court of Appeals for the Sixth Circuit, Cole, Circuit Judge, 538 F.3d 469, affirmed.

Certiorari was granted.

Holding: The Supreme Court, Justice Sotomayor, held that bona fide error defense in FDCPA does not apply to violation of FDCPA resulting from a debt collector's incorrect interpretation of legal requirements of the Act.

Syllabus [FN*]

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

***1** The Fair Debt Collection Practices Act (FDCPA), 15 U.S.C. § 1692 *et seq.*, imposes civil liability on "debt collector[s]" for certain prohibited debt collection practices. A debt collector who "fails to comply with any [FDCPA] provision ... with respect to any person is liable to such person" for "actual damage[s]," costs, "a reasonable attorney's fee as determined by the court," and statutory "additional damages." § 1692k(a). In addition, violations of the FDCPA are deemed unfair or deceptive acts or practices under the Federal Trade Commission Act (FTC Act), § 41 *et seq.*, which is enforced by the Federal Trade Commission (FTC). See § 1692*l*. A debt collector who acts with "actual knowledge or knowledge fairly implied on the basis of objective circumstances that such act is [prohibited under the FDCPA]" is subject to civil penalties enforced by the FTC. §§ 45(m)(1)(A), (C). A debt collector is not liable in any action brought under the FDCPA, however, if it "shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error." § 1692k(c).

Respondents, a law firm and one of its attorneys (collectively Carlisle), filed a lawsuit in Ohio state court on behalf of a mortgage company to foreclose a mortgage on real property owned by petitioner Jerman. The complaint included a notice that the mortgage debt would be assumed valid unless Jerman disputed it in writing. Jerman's lawyer sent a letter disputing the debt, and, when the mortgage company acknowledged that the debt had in fact been paid, Carlisle withdrew the suit. Jerman then filed this action, contending that by sending the notice requiring her to dispute the debt in writing, Carlisle had violated § 1692g(a) of the FDCPA, which governs the contents of notices to debtors. The District Court, acknowledging a division of authority on the question, held that Carlisle had violated § 1692g(a) but ultimately granted Carlisle summary judgment under § 1692k(c)'s "bona fide error" defense. The Sixth Circuit affirmed, holding that the defense in § 1692k(c) is not limited to clerical or factual errors, but extends to mistakes of law.

Held: The bona fide error defense in § 1692k(c) does not apply to a violation resulting from a debt collector's mistaken interpretation of the legal requirements of the FDCPA. Pp. — - —.

(a) A violation resulting from a debt collector's misinterpretation of the legal requirements of the FDCPA cannot be "not intentional" under § 1692k(c). It is a common maxim that "ignorance of the law will not excuse any person, either civilly or criminally." *Barlow v. United States,* 7 Pet. 404, 411, 8 L.Ed. 728. When Congress has intended to provide a mistake-of-law defense to civil liability, it has often done so more explicitly than here. In particular, the administrative-penalty provisions of the FTC Act, which are expressly incorporated into the FDCPA, apply only when a debt collector acts with "actual knowledge or knowledge fairly implied on the basis of objective circumstances" that the FDCPA prohibited its action. §§ 45(m)(1)(A), (C). Given the absence of similar language in § 1692k(c), it is fair to infer that Congress permitted injured consumers to recover damages for "intentional" conduct, including violations resulting from a mistaken interpretation of the FDCPA, while reserving the more onerous administrative penalties for debt collectors whose intentional actions reflected knowledge that the conduct was prohibited. Congress also did not confine FDCPA liability to "willful" violations, a term more often understood in the civil context to exclude mistakes of law. See, *e.g., Trans World Airlines, Inc. v. Thurston,* 469 U.S. 111, 125-126, 105 S.Ct. 613, 83 L.Ed.2d 523. Section 1692k(c)'s requirement that a debt collector maintain "procedures reasonably adapted to avoid any such error" also more naturally evokes procedures to avoid mistakes like clerical or factual errors. Pp. — - —.

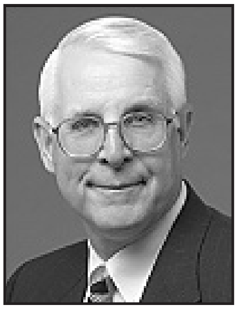
(b) Additional support for this reading is found in the statute's context and history. The FDCPA's separate protection from liability for "any act done or omitted in good faith in conformity with any [FTC] advisory opinion," § 1692k(e), is more obviously tailored to the concern at issue (excusing civil liability when the FDCPA's prohibitions are uncertain) than the bona fide error defense. Moreover, in enacting the FDCPA in 1977, Congress copied the pertinent portions of the bona fide error defense from the Truth in Lending Act (TILA), § 1640(c). At that time, the three Federal Courts of Appeals to have considered the question interpreted the TILA provision as referring to clerical errors, and there is no reason to suppose Congress disagreed with those interpretations when it incorporated TILA's language into the FDCPA. Although in 1980 Congress amended the defense in TILA, but not in the FDCPA, to exclude errors of legal judgment, it is not obvious that amendment changed the scope of the TILA defense in a way material here, given the prior uniform judicial interpretation of that provision. It is also unclear why Congress would have intended the FDCPA's defense to be broader than TILA's, and Congress has not expressly *included* mistakes of law in any of the parallel bona fide error defenses elsewhere in the U.S.Code. Carlisle's reading is not supported by *Heintz v. Jenkins,* 514 U.S. 291, 292, 115 S.Ct. 1489, 131 L.Ed.2d 395, which had no occasion to address the overall scope of the FDCPA bona fide error defense, and which did not depend on the premise that a misinterpretation of the requirements of the FDCPA would fall under that provision. Pp. — - —.

***2** (c) Today's decision does not place unmanageable burdens on debt-collecting lawyers. The FDCPA contains several provisions expressly guarding against abusive lawsuits, and gives courts discretion in calculating additional damages and attorney's fees. Lawyers have recourse to the bona fide error defense in § 1692k(c) when a violation results from a qualifying factual error. To the extent the FDCPA imposes some constraints on a lawyer's advocacy on behalf of a client, it is not unique; lawyers have a duty, for instance, to comply with the law and standards of professional conduct. Numerous state consumer protection and debt collection statutes contain bona fide error defenses that are either silent as to, or expressly exclude, legal errors. To the extent lawyers face liability for mistaken interpretations of the FDCPA, Carlisle and its *amici* have not shown that "the result [will be] so absurd as to warrant" disregarding the weight of textual authority. *Heintz, supra,* at 295, 115 S.Ct. 1489. Absent such a showing, arguments that the FDCPA strikes an undesirable balance in assigning the risks of legal misinterpretation are properly addressed to Congress. Pp. — - —.

538 F.3d 469, reversed and remanded.

SOTOMAYOR, J., delivered the opinion of the Court, in which ROBERTS, C.J., and STEVENS, THOMAS, GINSBURG, and BREYER, JJ., joined. BREYER, J., filed a concurring opinion. SCALIA, J., filed an opinion concurring in part and concurring in the judgment. KENNEDY, J., filed a dissenting opinion, in which ALITO, J., joined.

Prof. Dunaway, Section Editor, is Professor Emeritus, Pepperdine University School of Law.



Taxation Cases

Forrest Lewis
Plante & Moran PLLC

LIBERAL IRS RULING ON LOSS SUB CONTAINS SEVERAL GEMS

An extremely taxpayer favorable recent Internal Revenue Service private letter ruling, PLR 201011003, contains many helpful features. The ruling concerns a complicated series of events involving the sale of a loss subsidiary corporation which works out in the taxpayer's favor including turning one longstanding IRS position against it. This article presents a simplified version of the facts in the case to highlight the salient points.

The transaction

The ruling involves a corporate group with three tiers of subsidiaries which I will refer to as Parent, LossCo and LossCo subsidiaries. LossCo was insolvent and, as is often the case, was indebted to Parent. Parent contributed to capital enough of the LossCo debt to make LossCo solvent. Nevertheless, the IRS allowed Parent an ordinary loss deduction under Internal Revenue Code Section 165(g). Parent then sold LossCo to an unrelated party. The sale was designed as a Qualifying Stock Purchase to allow the buyer to benefit from a basis step-up due to a IRC 338(h)(10) election. LossCo then underwent a prepackaged Chapter 11 bankruptcy reorganization which presumably allowed them to get a further debt reduction.

Step-by-step

Since we went through that fast, we'll break down the steps. The beauty of the ruling is that for the most part you don't have to replicate the entire transaction but can benefit by taking those parts which apply to your situation.

1. Parent contributes intercompany loan to capital.

The issues surrounding this are the most complex in the entire transaction. Historically, parent corporations sometimes tried to contribute debt owed them by an insolvent subsidiary to make it solvent in order to prepare the subsidiary for a nontaxable sub-into-parent liquidation under IRC 332. Several court cases had held that the liquidation of an insolvent subsidiary into a parent was a taxable liquidation. IRS then issued landmark Revenue Ruling 68-602, still very much in force, which says that a transitory infusion of capital to an insolvent subsidiary will be ignored and a liquidation will be treated as taxable, a rule which usually hurts the taxpayer. In this case it is favorable as it permits the Parent to write off its stock in LossCo as worthless under IRC 165(g) which yields an ordinary loss deduction. The ordinary deduction for worthless stock is more valuable than the presumed capital loss on subsequent sale as capital losses can only be used to offset capital gain in corporations and often result in expired carryforwards. The ruling makes clear that the worthless stock write off is subject to the "unified loss rule" of Reg. 1.1502-36 which is intended to reduce the amount of "uneconomic" losses and eliminate losses deducted by the Parent which are duplicated in the basis or tax attributes of the subsidiary. Presumably, even after any effects of the "unified loss rule" there is a valuable ordinary loss deduction for the Parent. It is extremely helpful to the taxpayer that the IRS allowed the worthless stock loss just before the sale instead of insisting on a capital loss on the subsequent sale of the subsidiary.

2. Sale and 338(h)(10) basis step up election

Despite the fact that IRS ignored the capital contribution of debt, that step presumably increased the value of LossCo and helped make it saleable. A Qualified Stock Purchase was engineered in which the buyer purchased 80% of LossCo within a 12 month period, probably all in one day in this case. That permitted LossCo and its subsidiaries to make a 338(h)(10) election and execute a "deemed liquidation" which results in a step up of the LossCo and subsidiary assets to fair market value. The 338(h)(10) deemed liquidation is a substitute for an asset sale and is primarily a benefit for the buyer. So, the buyer is usually willing to pay a higher stock price to obtain that benefit.

3. Prepackaged bankruptcy reorganization

The immediate voluntary petition in bankruptcy by the new buyer is an unusual strategy but was apparently part of the grand design of this transaction. The reduction of debt in the bankruptcy would be an economic benefit for LossCo, but under IRC 108(b) it would require a reduction in favorable tax attributes in the same amount as the debt reduction. Presumably the discharge of debt in bankruptcy caused a reduction in net operating losses and asset tax basis in LossCo. Since there is no carryover of net operating losses in 338(h)(10), there likely would be a reduction in asset tax basis, the same tax basis that had just been increased. One assumes the increase in basis was greater than the subsequent reduction. (Remember, most of the favorable tax treatments in this ruling are separable and you do not have to incorporate every step of this transaction).

4. Treatment of passive income for qualifying for worthless stock deduction

In order to receive ordinary loss treatment under IRC 165(g), the worthless subsidiary has to have been an "active" corporation. Gross receipts from passive sources—dividends, interest, certain rents, capital gains, etc.—cannot exceed 10%. Apparently LossCo had a potential problem qualifying in this regard as one of its subsidiaries, referred to as "Checkbook", had apparently handled the group's cash management function, a common arrangement. The company in the ruling did not compute interest on intercompany balances, which is also fairly common. In the only notable anti-taxpayer holding in the ruling, the so called "look through", the IRS required two calculations to be made in regard to the 10% passive gross receipts test:

1. Interest and dividends on intercompany transactions had to be imputed.

2. Where LossCo has gross receipts from intercompany transactions, if the amount ultimately came from an external passive source (e.g. interest income), it will be treated as passive to LossCo.

These two steps increased the amount of passive income but the total did not exceed the 10% limit. (Similarly see PLR 200710004)

Conclusion

This ruling, PLR 201011003, presents several separable beneficial tax strategies for dealing with insolvent subsidiaries:

a) Obtaining a worthless stock ordinary deduction by turning the principle of Revenue Ruling 68-602 of ignoring transitory capital contributions of debt against IRS to gain their agreement that the company was still insolvent for tax purposes.

b) Using the capital contribution of debt to make the formerly worthless subsidiary more marketable.

c) Stepping up asset basis for the buyer through a 338(h)(10) election for which the seller probably was paid something extra.

The only negative presented in the ruling is further development of the "look through" doctrine by IRS trying to prevent the taxpayer from qualifying for an ordinary loss with the 10% passive gross receipts limit of IRC 165(g). Overall, a very taxpayer friendly ruling.

Thanks to Grant Newton and Dennis Bean for their assistance with this article and to Jack Cummings of Alston & Bird for his insights.

SOME TAXPAYERS CAN RECOVER ATTORNEY FEES FROM IRS

While it doesn't happen very often, the Internal Revenue Code provides for certain "small" taxpayers to be reimbursed for attorney fees and legal costs incurred in litigation with the Internal Revenue Service in three specific situations:

3. In the more common case, the taxpayer has "substantially prevailed" in an appeal or court case against the Internal Revenue Service,

4. The taxpayer has made a "qualified offer" as to his tax liability, which turns out to be equal to or less than the liability determined by the court, or

5. The taxpayer has successfully demonstrated that in the collection of federal taxes an IRS employee has made willful violations of the Internal Revenue Code or the Bankruptcy Code automatic stay or discharge injunction.

The rate limit on hourly fees set by the statute is indexed for inflation and amounts to $180 per hour for 2010. Reasonable administrative costs may also be awarded which include expert witness fees, studies, analyses, engineering reports, etc. necessary to the case. (In the discussion below I refer to the federal government as the IRS, but some of the steps are actually carried out by the Department of Justice).

Substantially prevailing party

In cases referred to under Paragraph 1 above where the taxpayer "substantially prevails" over the IRS in an appeal or in court, to be eligible to be awarded attorneys fees and costs, there is a net worth limitation of $2 million for individuals ($4 million joint) and $7 million for businesses. The taxpayer must have "exhausted all administrative remedies", i.e., made appeal within the IRS before proceeding to court. The taxpayer must apply for the award within 30 days of the final judgment. Even when the taxpayer has won a significant victory against the IRS, there is a major exception favorable to the IRS in which they can avoid paying if they can show that their position was "substantially justified." While the burden is technically on the IRS, they usually meet that burden as awards of fees and costs are rare.

Qualified offer

Similar to some rules in civil procedure, if the taxpayer makes an offer which meets certain conditions which the IRS refuses and the IRS proceeds to litigate, and the court ultimately determines the taxpayer's liability to be equal to or less than the offer amount, the taxpayer is entitled to attorneys' fees and costs. To be eligible for an award under the Qualified Offer rules, the taxpayer must meet the same net worth limitations discussed above. The IRS recently updated their internal procedures in this area in Chief Counsel Notice 2010-007.

Collection actions which are willful violations of Internal Revenue Code or bankruptcy automatic stay and discharge

The Internal Revenue Code provides for damages if, with respect to collection of a federal tax, any officer or employee of the IRS recklessly or intentionally, or by reason of negligence, disregards any provision of the Internal Revenue Code and its regulations or willfully violates section 362 (relating to automatic stay) or 524 (relating to effect of discharge) of the Bankruptcy Code. (There is also a provision allowing damages of up to $1 million against the government for reckless, intentional or negligent disregard of the Internal Revenue Code). But as stated earlier, it is extremely rare that anyone collects anything under these provisions.

Conclusion

For those interested in trying to recoup attorney fees and litigation costs in tax controversies with the IRS, you should contact your legal counsel as there are many detailed hurdles to overcome. Obviously, a cost-benefit analysis should be made in view of the peculiar facts of your case.

Thanks to Grant Newton and Dennis Bean for their assistance.

Forrest Lewis, CPA is a tax practitioner based in East Lansing, Michigan.

Bankruptcy Cases

Baxter Dunaway

SEC Charges Goldman Sachs with Fraud in Structuring and Marketing of Collateralized Debt Obligations (CDOs) Tied to Subprime Mortgages

On April 16, 2010, in a major showdown between the Securities & Exchange Commission (SEC) and Wall Street[1], Goldman Sachs Group Inc. – one of the few Wall Street generators of collateral debt obligations (CDOs) comprising or tied to sub-prime mortgage-backed securities to thrive during the financial crisis – was charged in a civil complaint with deceiving investor clients by selling them mortgage securities secretly designed by a hedge-fund firm run by John Paulson, who made a killing betting on the housing market's collapse.[2] On April 16, 2010, the SEC charged Goldman, Sachs & Co.("GS&Co") and one of its vice presidents Fabrice Tourre ("Tourre"), for defrauding investors by misstating and omitting key facts about a financial product tied to subprime mortgages as the U.S. housing market was beginning to falter.[3] The SEC alleges that Goldman Sachs structured and marketed a synthetic collateralized debt obligation (CDO)[4] that hinged on the performance of subprime residential mortgage-backed securities (RMBS). Goldman Sachs failed to disclose to investors vital information about the CDO, in particular the role that a major hedge fund played in the portfolio selection process and the fact that the hedge fund had taken a short position against the CDO, that is, betting that the CDO would lose value.[5] "The product was new and complex but the deception and conflicts are old and simple," said Robert Khuzami, SEC Director of the Division of Enforcement. "Goldman wrongly permitted a client that was betting against the mortgage market to heavily influence which mortgage securities to include in an investment portfolio, while telling other investors that the securities were selected by an independent, objective third party." Kenneth Lench, Chief of the SEC's Structured and New Products Unit, added, "The SEC continues to investigate the practices of investment banks and others involved in the securitization of complex financial products tied to the U.S. housing market as it was beginning to show signs of distress." The SEC alleges that one of the world's largest hedge funds, Paulson & Co., paid Goldman Sachs to structure a transaction in which Paulson & Co. could take short positions against mortgage securities chosen by Paulson & Co. based on a belief that the securities would experience credit events.[6] According to the SEC's complaint, filed in U.S. District Court for the Southern District of New York, the marketing materials for the CDO known as ABACUS 2007-AC1 (ABACUS) all represented that the RMBS portfolio underlying the CDO was selected by ACA Management LLC (ACA), a third party with expertise in analyzing credit risk in RMBS. The SEC alleges that undisclosed in the marketing materials and unbeknownst to investors, the Paulson & Co. hedge fund, which was poised to benefit if the RMBS defaulted, played a significant role in selecting which RMBS should make up the portfolio. The SEC's complaint alleges that after participating in the portfolio selection, Paulson & Co. effectively shorted the RMBS portfolio it helped select by entering into credit default swaps (CDS) with Goldman Sachs to buy protection on specific layers of the ABACUS capital structure. Given that financial short interest, Paulson & Co. had an economic incentive to select RMBS that it expected to experience credit events in the near future. Goldman Sachs did not disclose Paulson & Co.'s short position or its role in the collateral selection process in the term sheet, flip book, offering

1 "Goldman vigorously denied the Securities and Exchange Commission's civil charges, setting up the biggest clash between Wall Street and regulators since junk-bond king Drexel Burnham Lambert succumbed to a criminal insider-trading investigation in the 1980s, helping to define the era." Gregory Zuckerman, Susanne Craig and Serena Ng, SEC Charges Goldman With Fraud - SEC Alleges Firm Misled Investors on Securities Linked to Subprime Mortgages-Major Escalation in Showdown With Wall Street, WSJ 4/17/2010 A1.

2 Gregory Zuckerman, Susanne Craig and Serena Ng, SEC Charges Goldman With Fraud - SEC Alleges Firm Misled Investors on Securities Linked to Subprime Mortgages-Major Escalation in Showdown With Wall Street, WSJ 4/17/2010 A1.

3 Litigation Release No. 21489, http://www.sec.gov/news/press/2010/2010-59.htm; SEC Complaint: Securities and Exchange Commission v. Goldman Sachs & Co. and Fabrice Tourre, 2010 WL 1508202 (S.D.N.Y. 2010) (No. 1:10CV03229); Gregory Zuckerman, Susanne Craig and Serena Ng, SEC Charges Goldman With Fraud - SEC Alleges Firm Misled Investors on Securities Linked to Subprime Mortgages-Major Escalation in Showdown With Wall Street, WSJ 4/17/2010 A1 .

4 See generally, Dunaway, Vol. 4 The Law of Distressed Real Estate, Chapter 56 Asset Securitization and Commercial Mortgage-Backed Securities and Chapter 55A. Subprime Mortgage and Mortgage-Backed Securitization Litigation § 55A:6. Collateralized debt obligations (Thomson/West 2010 and Westlaw: LAWDRE). In a cash flow structured finance transaction, an issurer conveys ownership of the assets to a special-purpose entity (SPE), which then issues the rated debt. Principal and interest related to those assets are conveyed along with the risks. In synthetic securities, only the risk is transferred. De Servigny and Jost, The Handbook of structured Finance, 544 (Standard & Poor 2007).

5 "2. GS&Co marketing materials for ABACUS 2007-AC1 – including the term sheet, flip book and offering memorandum for the CDO – all represented that the reference portfolio of RMBS underlying the CDO was selected by ACA Management LLC ("ACA"), a third-party with experience analyzing credit risk in RMBS. Undisclosed in the marketing materials and unbeknownst to investors, a large hedge fund, Paulson & Co. Inc. ("Paulson"), with economic interests directly adverse to investors in the ABACUS 2007-AC1 CDO, played a significant role in the portfolio selection process. After participating in the selection of the reference portfolio, Paulson effectively shorted the RMBS portfolio it helped select by entering into credit default swaps ("CDS") with GS&Co to buy protection on specific layers of the ABACUS 2007-AC1 capital structure. Given its financial short interest, Paulson had an economic incentive to choose RMBS that it expected to experience credit events in the near future. GS&Co did not disclose Paulson's adverse economic interests or its role in the portfolio selection process in the term sheet, flip book, offering memorandum or other marketing materials provided to investors." SEC Complaint, Item 2.

6 "16. Paulson discussed with GS&Co possible transactions in which counterparties to its short positions might be found. Among the transactions considered were synthetic CDOs whose performance was tied to Triple B-rated RMBS. Paulson discussed with GS&Co the creation of a CDO that would allow Paulson to participate in selecting a portfolio of reference obligations and then effectively short the RMBS portfolio it helped select by entering into CDS with GS&Co to buy protection on specific layers of the synthetic CDO's capital structure." SEC Complaint, Item 16.

memorandum, or other marketing materials provided to investors. The SEC alleges that Goldman Sachs Vice President Fabrice Tourre was principally responsible for ABACUS 2007-AC1. Tourre structured the transaction, prepared the marketing materials, and communicated directly with investors. Tourre allegedly knew of Paulson & Co.'s undisclosed short interest and role in the collateral selection process. In addition, he misled ACA into believing that Paulson & Co. invested approximately $200 million in the equity of ABACUS, indicating that Paulson & Co.'s interests in the collateral selection process were closely aligned with ACA's interests. In reality, however, their interests were sharply conflicting.

As the transaction was being structured, according to the complaint without full disclosure to the investors, in internal emails Tourre gloated over his role in the structuring and noted that the CDO bubble was about to burst.[7] However, the problems of a plaintiff in relying on e-mail evidence, at least in obtaining a guilty jury verdict based on a criminal complaint for fraud, is illustrated in United States v. Cioffi, Ralph; Tannin, Matthew.[8]

According to the SEC's complaint, the deal closed on April 26, 2007, and Paulson & Co. paid Goldman Sachs approximately $15 million for structuring and marketing ABACUS. By Oct. 24, 2007, 83 percent of the RMBS in the ABACUS portfolio had been downgraded and 17 percent were on negative watch. By Jan. 29, 2008, 99 percent of the portfolio had been downgraded. Investors in the liabilities of ABACUS are alleged to have lost more than $1 billion. The SEC's complaint charges Goldman Sachs and Tourre with violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5. The Commission seeks injunctive relief, disgorgement of profits, prejudgment interest, and financial penalties.[9]

Goldman Sachs defense: Wells submission

Prior to the SEC filing a complaint, in response to the SEC notification to the potential defendant that the SEC has conducted an investigation and may file a complaint, the Defendant may file a Wells submission with the objective to convince the SEC not to file a complaint:

"Absent extraordinary circumstances, such as the need to obtain a temporary restraining order freezing illegal profits or preserving original documents, the staff usually provides potential defendants and respondents an opportunity to respond in writing to the staff's recommendation. This response, called a Wells submission, is provided to the Commission along with the staff's recommendation and generally contains factual and legal arguments why the Commission should not authorize enforcement action in a given case. After the staff makes a recommendation, the matter is scheduled for discussion by the Commission at a non-public or "closed" Commission meeting attended only by the Commissioners and the staff."[10]

The summary from the Goldman, Sachs "Wells Submission" is as follows:[11]

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

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In the Matter of ABACUS CDO:
File No. HO-10911

SUBMISSION ON BEHALF OF GOLDMAN, SACHS & CO.

Goldman, Sachs & Co. ("Goldman Sachs") makes this submission in response to the Staff's proposed recommendation that an enforcement action be brought against Goldman Sachs. [footnote deleted] No such action is warranted.

PRELIMINARY STATEMENT

In early 2007, Goldman Sachs acted as the underwriter of privately-placed notes issued in a synthetic CDO transaction known as ABACUS 2007-AC1 ("2007-AC1"). There was nothing unusual or remarkable about the transaction or the portfolio of assets it referenced. Like countless similar transactions during that period, the synthetic portfolio consisted of dozens of Baa2-rated subprime residential mortgage-backed securities (RMBS") issued in 2006 and early 2007 that were identified in the offering materials (the "Reference Portfolio"). As in other synthetic CDO transactions, by definition someone had to assume the opposite side of the portfolio risk, and the offering documents made clear that Goldman Sachs, which took on that risk in the first instance, might transfer some or all of it through a hedging and trading strategies using derivatives.

7 " 18. At the same time, GS&Co recognized that market conditions were presenting challenges to the successful marketing of CDO transactions backed by mortgage-related securities. For example, portions of an email in French and English sent by Tourre to a friend on January 23, 2007 stated, in English translation where applicable: "More and more leverage in the system, the whole building is about to collapse anytime now...Only potential survivor, the fabulous Fab[rice Tourre]... standing in the middle of all these complex, highly leveraged, exotic trades he created without necessarily understanding all of the implications of those monstruosities!!!" Similarly, an email on February 11, 2007 to Tourre from the head of the GS&Co structured product correlation trading desk stated in part, 'the cdo biz is dead we don't have a lot of time left.' " SEC Complaint, Item 18.

8 United States v. Cioffi, Ralph; Tannin, Matthew, Case No. 08-CR-415 (FB), 2009 Jury Verdicts LEXIS 410365; 1 Exp. Wit. 258946, (USDC Eastern District N.Y. 2009) ("Verdict awarded to Defendant"). The Cioffi case is discussed in § 44B:13 "Choice of using civil or criminal remedies", Vol. 4 Dunaway, The Law of Distressed Real Estate (Thomson/West 2010 and Westlaw: LAWDRE).

9 For more information about this enforcement action, contact: Lorin L. Reisner Deputy Director, SEC Enforcement Division (202) 551-4787, Kenneth R. Lench Chief, Structured and New Products Unit, SEC Enforcement Division (202) 551-4938.

10 Linda Chatman Thomsen Deputy Director Division of Enforcement , U.S. Securities and Exchange Commission, "AN OVERVIEW OF ENFORCEMENT"(2005) [Source SEC Commission's web site at <www.sec.gov>.] For a discussion of "Wells Submissions", see Wells Submissions, 5 Bromberg & Lowenfels on Securities Fraud §§ 12:104 to 12:106 (2d ed.) (Westlaw: SECBROMLOW § 12:104).

11 Obtained by search on Google, with the query: ABACUS CDO HO-10911 Goldman.

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Like other transactions of this type, all participants were highly sophisticated institutions that were knowledgeable about subprime securitization products and had both the resources and the expertise to perform due diligence, demand any information that was important to them, analyze the portfolio, form their own market views and negotiate forcefully at arm's length. And like other transactions with similar lower-rated subprime portfolios, 2007-AC1's performance was battered by the unprecedented subprime market meltdown, which has impaired cash flow to countless note holders in such transactions and caused many participants in the market to fail altogether.

Now, with the benefit of perfect hindsight about the magnitude of the market downturn, the Staff proposes to charge Goldman Sachs with misrepresenting material facts relating to the offering. Notably, the Staff does not contend that anything about the Reference Portfolio itself was incorrectly disclosed. Rather, the Staff's theory relates exclusively to the role of Paulson & Co., Inc. ("Paulson") - now recognized as a heavy bettor against the subprime market but at the time a relatively unknown hedge fund manager - in making suggestions to the independent selection agent as to the composition of the Reference Portfolio and taking a negative position on that portfolio through a swap with Goldman Sachs. Moreover, the Staff proposes not only to base its charges on theories of negligence under Section 17(a) of the Securities Act of 1933, but also to assert that Goldman Sachs made intentional misrepresentations concerning Paulson in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. There is no basis in the law, the record or common sense for such charges.

First, what was important to the note investors, as embodied in Regulation AB, were the offering documents' descriptions of the Reference Portfolio and the distribution of proceeds, which sophisticated institutional investors in asset-backed securities input into their models in order to make their investment decisions based on their views of market and housing trends. This information was accurately disclosed, and the Staff does not contend otherwise. By contrast, we are aware of no synthetic CDO offering that disclosed how the protection buyer would manage the risk it took on, other than to disclose generally that it may do so, as occurred here. Certainly, nothing in Regulation AB requires disclosure of the underwriter's risk tolerance over time.

Second, given the absence of an affirmative directive in Regulation AB to disclose the involvement of Paulson, the Staff relies on a theory that references in the offering documents to the Portfolio Selection Agent were misleading because they somehow implied that the agent, ACA Capital Management LLC ("ACA"), picked the portfolio in isolation without input from any participant, including ones whose true economic interests at the time were opposite those of the note holders. But the Reference Portfolio, however it was selected, was fully disclosed and available for all to evaluate on its merits. To the extent that investors took comfort from ACA's involvement, it was only because an independent expert had approved the portfolio, and that is precisely what ACA did. ACA plainly exercised its own judgment in deciding which securities were included (whatever its impression as to the economic interests of Paulson), rejected dozens that it disliked, and was entirely satisfied with the resulting portfolio. Indeed, ACA put its own money behind its analysis by investing in the notes itself and entering into a large swap referencing the portfolio. There is no industry definition of "Portfolio Selection Agent" that implied that ACA would operate within an ivory tower or refuse to consider suggestions made by interested parties in exercising its independent judgment. In fact, it was a customary feature of the market that participants (including those here) often offered their views on potential securities to be included in referenced portfolios, so no one would have been surprised that Paulson was doing so.

Third, and more fundamentally, while Paulson's investment strategy and success are well known today, nothing in the record establishes that Paulson's involvement would have been significant in early 2007 to anyone involved in the 2007-AC1 transaction. All participants in the transaction understood that someone had to take the other side of the portfolio risk, and the offering documents clearly stated that Goldman Sachs might lay off some or all of the short exposure to the portfolio that it had taken on. A disclosure that the relatively unknown Paulson was the entity to which Goldman Sachs transferred that risk would have been immaterial to investors in April 2007.

Fourth, there is no basis to suggest that the portfolio would have performed any differently or that the economic outcome for the participants would have changed in the least had Paulson's role and interest been more transparent. The portfolio that ACA originally selected had the same characteristics as the Reference Portfolio, and both experienced virtually the same poor performance in the face of the subprime meltdown. Further, the principal note investor, IKB Deutsche Industriebank AG ("IKB"), was an active investor in the CDO markets, had expressed its specific interest in transactions like 2007-AC1, had invested in similar ABACUS transactions before, and thoroughly evaluated the portfolio. ACA was a major player in the CDO marketplace with billions under management and had every reason - reputationally and economically - perform its job well. ABN Amro ("ABN"), which intermediated Goldman Sachs' swap with ACA, showed little interest in the portfolio and relied instead as a swap intermediary on the credit of its other swap counterparty, ACA, which proved fatal when ACA failed. In the end, every portfolio of lower-rated subprime RMBS was decimated in the market meltdown, and any marginal differences in bond quality underlying th Staff's theory would not have resulted in any materially different outcome.

Fifth, beyond these fatal deficiencies in the Staff's materiality theory, there is no basis for a finding that Goldman Sachs made any alleged misrepresentations about Paulson's role with the negligence required under Section 17(a), much less with the scienter mandated by Section 10(b). The Staff has pointed to two ambiguous statements contained in an e-mail from Goldman Sachs that it contends caused ACA to infer that Paulson would be an equity investor. As an initial matter, it is difficult to reconcile such an inference with the Staff's theory that Paulson tried to influence ACA to select dozens of riskier Baa2-rated securities, which would have raised questions about Paulson's true economic interests for any sophisticated market participant. The record, in all events, contains no evidence that Goldman Sachs caused ACA to infer that Paulson had an equity position. Nor does the record support the conclusion that any confusion by ACA as to the nature of Paulson's involvement in 2007-AC1 changed how ACA selected the Reference Portfolio. Similarly, the absence of any disclosure of Paulson's role did not affect IKB's decision to invest. IKB regularly invested through Goldman Sachs and other firms in numerous CDOs and other complex securities and conducted its own evaluations of the underlying reference portfolios, including for the 2007-AC1 transaction.

Finally, the Staff's proposed theory ignores the fact that, as a broker-dealer acting as an intermediary on behalf of a client, Goldman Sachs had a duty to keep information concerning its client's (Paulson's) trades, positions and trading strategy confidential. The Staff itself has recognized this obligation in other contexts, but seeks here to impose a duty to disclose the identity and market views of swap counterparties.

In short, the Staff's contention that Goldman Sachs had a duty to disclose Paulson's involvement in the process by which ACA selected the portfolio is without support in either the factual record or the law, would impose obligations not recognized in existing law and would be directly contrary to market practice, where broker-dealers intermediate between parties taking opposite views and do not disclose those parties' identity or roles to each other. No enforcement action is warranted even on the existing record. If this matter is litigated, Goldman Sachs is confident that a fuller record - including its own discovery of all transaction participants - will underscore that no one in fact considered Paulson's role important and that no one was misled.

*** [remainder sets forth arguments and citations]

"One part of Goldman's defense has been that it lost $90 million in the transaction, arguing that it 'surely didn't wish to structure an investment in which we lost money.' In fact, the firm never intended to buy any of the deal; it just couldn't sell all the instruments to other investors-hence the loss, say people familiar with the matter."[12]

Morgan Stanley criminal investigation

In May, 2010, U.S. prosecutors announced that they were conducting a criminal investigation into whether Morgan Stanley misled investors about mortgage-derivatives deals it helped design and sometimes bet against.[13] Investigators are examining, among other things, whether Morgan Stanley made proper representations about its roles. Morgan Stanley helped design the deals and bet against them but didn't market them to clients. The probe is at a preliminary stage. Bringing criminal cases involving complex Wall Street deals is a huge challenge for prosecutors. The government must prove beyond a reasonable doubt that a firm or its employees knowingly misled investors, a high bar. There are differences between the SEC v. Goldman Sachs case and the Morgan Stanley transaction. Morgan Stanley bet against the investments in the CDOs, but didn't sell the deal to investors. In the Abacus case, Goldman underwrote the deal, but didn't bet against it.[14] ■

12 Kara Scannell, SEC Split on Goldman Case, WSJ 4/20/2010 A1, 6.

Business continues from **Page 1**

forbear, continue funding on credit lines and possibly stand still on term debt principal payments. If creditors feel confident that customers will stay and agree to pay their payables without offset and not assert damages for any production disruption or other issue, this would further encourage the creditors to cooperate with the Company. As these examples illustrate, as more information becomes known, stakeholders' needs and issues will change which in turn will affect other stakeholders' needs and concerns. This iterative process will continue as more information becomes available and terms among the parties are being negotiated and term sheets defined.

Stakeholders must come to an agreement regarding what they are or are not willing to do over the mid-term (4-13+ weeks) to provide time to develop a longer term solution. The terms of these agreements need to be documented and the financial impact incorporated into the 13-week cash forecast.

Viability assessment

Probably the most critical factor in determining the future of the business in crisis is its future viability. If a business is clearly not viable, then the decision can be made early-on to wind-down and liquidate. In most cases the assessment is not so straightforward. It takes time to analyze the profit potential of the various components of the business, which requires identification of possible cost reductions, asset or segment dispositions, customer demand and commitment, employee cooperation and support of needed changes, the ability to obtain long-term funding and many other factors.

The viability assessment, like the stakeholder assessment, is also an iterative process. As the stakeholders' interests and needs are better defined the viability is affected. As the degree of support and concessions required for viability becomes more apparent, the stakeholder needs and interests may change. For example, customers may be willing to accept a 10% price increase; however, if a 20% increase is required for viability, the customers may decide to exit from the supplier. If the employees or union are unwilling to accept changes to work rules or agree to wage and benefit concessions, the Company may be unable to reduce its costs to be viable.

An initial viability assessment is needed for the stakeholders to begin to assess their alternatives and positions. Before a long-term strategy can be defined, the Company must demonstrate that it is viable and that it has the necessary support from its stakeholders. A final viability assessment is generally required by the stakeholders before any long-term agreements are completed.

On-going activities

After "week one" there are several on-going activities that need to be in place throughout the recovery period until long-term solutions and agreements are negotiated and implemented.

The daily tracking of cash receipts, purchases, disbursements, and line of credit availability requires real-time information and consistent management and control. Re-establishing and maintaining credibility with vendors requires that commitments are not made that cannot be met and that all commitments are honored. This takes tight control over making commitments, knowing what commitments can be made and then managing closely to make sure everything happens in accordance with the commitment.

Special reporting procedures are generally required by creditors that will need to be established and maintained. Daily or weekly borrowing base filings may be required. Other financial information may now be required or submitted more frequently, such as daily aging of accounts receivable, detailed cash disbursements, rolling 13-week cash flow forecasts and others.

It is important that the Company is responsive and consistently provides the information requested. Creditors are very concerned when a business is in crisis and the consistent receipt of good information generally increases their level of comfort and trust.

Additionally, ongoing consideration should be made regarding the need to file for protection under the Bankruptcy code. If the creditors are uncooperative and unwilling to stand still, or there are significant executive contracts that need to be rejected, bankruptcy may become necessary to preserve the value of the estate and/or return to viability. If filing becomes necessary, the Company will need to support its professionals by providing financial information required for filing and preparing certain reports and analyses for the Court going forward.

Finally, a communication process must be defined and implemented. How and when will the various stakeholders be updated? Who has authority to speak on behalf of the Company with the various stakeholders? Commitments to follow up on open issues, to provide updates, and to present new information need to be managed, controlled and executed timely. Keeping these commitments is critical to establishing trust with the stakeholders.

Summary

The time period after "week one" in a business crisis is very demanding. While still dealing with multiple short-term issues, the focus needs to be expanded towards the mid-term or next 13-week period. At the end of "week one" the Company will have a short window (2-4 weeks) to develop a strategy and gain stakeholder acceptance necessary for the Company to survive through the mid-term (approximately a 13-week period).

The mid-term period allows time for the Company and its professionals to identify the longer term alternatives which may be possible given the financial, stakeholder and viability assessments. During this period it is critical to improve the trust and credibility among the Company and the stakeholders. The stakeholders must be confident that the situation is being handled by the Company and its professionals in an efficient, forthright and equitable manner. ■

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Deloitte Financial Advisory Services LLP's Reorganization Services group is a nationally recognized practice that specializes in providing in-depth business and financial advisory services to companies, their creditors, their equity holders, the legal community, bank syndicates and other interested parties in both in-court and out-of-court reorganizations. With strong experience in nearly every major industry and the ability to leverage the national resources of Deloitte LLP and its subsidiaries and the global resources of the Deloitte Touche Tohmatsu ("DTT") network of member firms, we are able to serve the complex needs of our clients. Years of experience in transaction-based, complex restructurings provides the basis to ask the appropriate questions and prioritize our work in a way that enables us to deliver meaningful answers to our clients. Our experience also enables us to assist in bringing order to difficult situations and to help build the consensus necessary to achieve a final resolution.

D. R. Payne & Associates, Inc.

D. R. Payne & Associates (DRPA), Business Valuators & Appraisers (BVA) and Renewal & Recovery Professionals (RRP) can provide a complete array of products and services to assist managers, shareholders, legal advisors and businesses with those key decisions by offering: business valuations and asset appraisals; business brokerage and transactional assistance; business strategy and family/business financial planning; corporate restructuring and refinancing advice; as well as tax planning, evaluation and representation. For enterprises experiencing more turbulent conditions, member firms provide: damage assessments, litigation and forensic accounting services; tax and regulatory assistance; turnaround and interim management; court appointed oversight and regulatory assistance; and reorganization and insolvency consultation.

Duane Morris LLP

Duane Morris

Lawyers in Duane Morris' Business Reorganization and Financial Restructuring Practice Group work closely with each client, whether debtor, trustee, insurer, lender or other creditor or party in interest, including acquirers of distressed businesses, to determine appropriate strategies for deriving maximum value from a troubled entity while remaining mindful of each client's goals. Clients draw on the firm's extensive reorganization experience gained from its involvement in many of the largest restructurings of the past three decades and the capabilities of a national team of bankruptcy lawyers in jurisdiction across the United States. Duane Morris LLP is a 650-lawyer, full-service law firm.

KPMG

FTI

FTI Consulting is a global business advisory firm dedicated to helping organizations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. With more than 2000 professionals located in most major business centers in the world, we work closely with clients every day to anticipate, illuminate, and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management and restructuring. More information can be found at www.fticonsulting.com

GlassRatner
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GlassRatner Advisory & Capital Group LLC

GlassRatner is a specialty financial services firm providing solutions to complex business problems. The firm applies a unique mix of skill sets and experience to address matters of the utmost importance to an enterprise such as managing through a business crisis or bankruptcy, planning and executing a major acquisition or divestiture, pursuing a fraud investigation or corporate litigation and other non-typical business challenges.

The combination of proven operating and financial expertise and an absolute focus on assignment execution makes GlassRatner a unique and valuable ally for its clients and partners.

Learn more at www.glassratner.com

Gordon Brothers Group
EST. 1903

Founded in 1903, Gordon Brothers Group is a global advisory, restructuring and investment firm specializing in the retail, consumer products, real estate and industrial sectors. Capabilities include asset valuations, dispositions and appraisals, real estate consulting and acquisitions, retail store operations, lending, equity investments, restructuring and advisory services. During the past three years, Gordon Brothers Group has appraised over $100 billion of assets, managed more than 7,000 stores, sold more than $10 billion of inventory, and restructured or sold over 120 million square feet of retail space. The firm currently owns over 1,600 stores through various portfolio companies.

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GT GreenbergTraurig

Greenberg Traurig, LLP is an international, full-service law firm with 1,750 attorneys and governmental affairs professionals in the United States, Europe and Asia. Our Business Reorganization and Bankruptcy Practice is one of the largest and most active in the United States. As part of an integrated international network of professionals who focus on all aspects of insolvency, our attorneys respond quickly to complex troubled situations arising anywhere and in any industry. Our understanding of different cultures and business practices is a critical aspect to the success of cross-border restructurings. For more information, please visit www.gtlaw.com.

Huron CONSULTING GROUP

Huron's Corporate Advisory Services team provides consulting assistance to financially distressed companies, creditor constituencies, and other stakeholders in connection with out-of-court restructurings and bankruptcy proceedings. The firm's executives work closely with management to create, analyze, and implement strategies that secure the future of the distressed company. Huron identifies underlying operational issues, not just financial problems, to maximize the organization's value to shareholders, creditors and employees. Huron's Corporate Advisory Services team of operating and financial professionals in the United States and Europe provides a broad range of functional, industry, and cross border expertise.

JONES DAY® | One Firm Worldwide℠

Tracing our origins to 1893, Jones Day now encompasses more than 2,300 lawyers resident in 30 locations worldwide and ranks among the world's largest and most geographically diverse law firms. Surveys repeatedly list Jones Day as one of the law firms most frequently engaged by U.S. corporations, and our commitment to our clients has repeatedly earned the Firm the No. 1 ranking for client service by the BTI Consulting Group. With one of the premier restructuring practices in the world, comprising approximately 100 lawyers Firmwide, Jones Day has also been consistently ranked among the top law firms in restructuring and reorganization both domestically and internationally.

ZC ZOLFO COOPER

RSM McGladrey

K Kapila & Company

K&C, one of the foremost insolvency/creditors' rights and litigation consulting practices in South Florida, is located in Fort Lauderdale.

The Firm's extensive experience includes securities fraud, financial institutions, manufacturing, health care, mutual funds, not-for-profit organizations, commodities brokers, retail, construction and distribution. K&C specializes in creditor negotiations, implementing turnaround strategies and restructuring negotiations for under-performing companies.

K&C is regarded as a leader in providing services in areas of creditors' rights matters, insolvency taxation, business analysis, troubled business turnaround, complex commercial litigation support for lost profits and damages and securities fraud.

K&C's Forensic Technology Group investigates computer and cyber fraud/crime.

MACQUARIE

Macquarie Capital (USA) Inc. offers restructuring advisory services to corporations and creditors operating in stress, distress or bankruptcy through its Restructuring & Special Situations group (MRSS). MRSS combines the experience and expertise of its professionals with the global Macquarie platform to create one of the most versatile restructuring practices in the industry.

Macquarie Capital (USA) Inc. is part of the Macquarie Group, a diversified international provider of financial, advisory and investment services, with approximately US$200 billion of total assets under management (as of December 31, 2007). Headquartered in Sydney, Australia, Macquarie Group Limited is listed on the Australian Securities Exchange (ASX:MQG) and employs more than 13,100 people in 25 countries.

Mesirow Financial™ CONSULTING

Mesirow Financial Consulting, LLC is one of the nation's leading full-service financial advisory service providers. We offer specialized expertise on a global, national and local level to assess complex situations and provide seasoned advice across a broad range of matters. Our commitment is to use our knowledge and experience to empower our clients, providing them with a clear understanding of their options and the ability to take decisive action. Our services include corporate recovery, litigation and investigative services, valuation services, interim management, operations and performance improvement, distressed mergers and acquisitions, alternative investment services, due diligence services and technology advisory services. Interim management services are offered through Mesirow Financial Interim Management, LLC. For more information, please visit our Web site at www.mesirowfinancial.com/mfc.

Realizing Value … Delivering Results

Navigant Capital Advisors is the dedicated corporate finance business unit of Navigant Consulting, Inc. (NYSE:NCI). With worldwide presence in 40 locations and over 1,900 professionals, Navigant Consulting, Inc. is one of the largest and most respected consulting firms in the world.

Navigant Capital Advisors provides financial advice for restructuring and turnaround situations, mergers and acquisitions, private placements, capital raising, valuations and transaction advisory services. Our dedicated professionals offer independent and objective advice supported by advanced technical skills, proven competence and in-depth industry knowledge.

For more information, please visit our website at www.ncacf.com.

Legal Counsel to Great Companies®

International law firm Perkins Coie serves great companies ranging in size from start-ups to FORTUNE 100. We represent debtors and creditors, as well as third parties purchasing assets from bankruptcy estates. Our primary clients in Chapter 11 reorganization cases are business debtors, secured and unsecured creditors, court-appointed trustees and creditors' committees. We also represent federally insured financial institutions, commercial mortgage-backed securities special servicers, pension fund administrators, asset-based lenders, trade creditors and public debt holders. Clients have access to the full-service resources of Perkins Coie. This means faster, more efficient service, particularly in larger, complicated Chapter 11 reorganizations.

Young Conaway Stargatt & Taylor, LLP ("YCS&T"), one of Delaware's most prominent law firms, has been repeatedly identified in the media as Delaware's leading bankruptcy firm. YCS&T's Bankruptcy and Corporate Restructuring Section is one of the largest in the Mid-Atlantic region with approximately 30 attorneys that bring skill, experience and creativity to clients involved in large and complex restructurings. YCS&T combines the talents and expertise of lawyers from various sections and disciplines with those of the Bankruptcy and Corporate Restructuring Section to provide a full array of services to clients in achieving successful results in and out of bankruptcy.

Independent Risk Consulting

Protiviti Inc.

Protiviti is a leading global provider of business risk consulting services. Our Corporate Restructuring & Recovery Practice specializes in providing restructuring and insolvency services, litigation consulting, and forensic accounting. Our professionals have extensive experience and knowledge in developing and implementing successful plans of reorganization, vendor and stakeholder negotiations, liquidating estate assets, and providing a full range of valuation services and expert testimony. We represent debtors, committees of unsecured creditors, secured lenders, fiduciaries and other interested parties. Protiviti, which employs more than 3,500 professionals in more than 60 locations throughout the Americas, Asia-Pacific and Europe, is a wholly owned subsidiary of Robert Half International Inc.

Weiser LLP, with its ranking as one of the top 20 accounting firms and one of Bankruptcy Insider's top 20 non-investment banking financial advisory firms, is ideally positioned to understand and serve all constituents in a distressed situation. Weiser's accomplished restructuring professionals provide the following:

Expert witness testimony | Bankruptcy taxation services | Mergers and acquisitions services | Advice on 363 transactions | Fresh start accounting | Forensic services | Operational turnaround implementation

LAW OFFICES STUTMAN TREISTER & GLATT PROFESSIONAL CORPORATION

Stutman, Treister & Glatt PC is a firm of 31 attorneys, all of whom specialize in business reorganization, bankruptcy, and insolvency law. Since 1948, the firm has been a national leader in the bankruptcy and reorganization field and remains one of the preeminent firms in its field. Members of the firm have served and continue to serve as counsel to debtors, creditor committees, equity committees, bondholders, hedge funds, distressed investors and parties to bankruptcy-related litigation. The collective experiences associated with this diverse reorganization practice allows Stutman, Treister & Glatt to provide exceptional legal services and expertise to its clients in complex transactions.

Phelps Consulting Group is a boutique business-performance firm based in Los Angeles. We specialize in financial forensics and turnaround consulting. Our professional staff includes seasoned CPAs, Certified Fraud Examiners, tax experts, and operations consultants. We have many years—over 20—of experience with turnarounds, restructurings, and crisis management of troubled companies. We're usually engaged by bankers, attorneys, creditors, business boards, and investors of companies in the $20 million to $500 million revenue range.

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John Surdoval
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MEMBERS ON THE MOVE

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If you would like to report a recent move, please go online to www.aira.org

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Ojas Shah
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James Trankina
Navigant Capital Advisors LLC

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CLUB 10

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FTI Consulting Inc	**83**
Alvarez & Marsal LLC	**64**
AlixPartners, LLP	**60**
KPMG LLP	**35**
Zolfo Cooper	**28**
Deloitte.	**27**
Grant Thornton LLP	**27**
LECG LLC	**21**
Loughlin Meghji + Company	**21**
Navigant Capital Advisors LLC	**21**
Capstone Advisory Group LLC	**19**
Huron Consulting Group LLC	**18**
Mesirow Financial Consulting LLC	**18**
BDO	**17**
CRG Partners Group LLC	**17**
PricewaterhouseCoopers LLP	**13**
Protiviti Inc	**12**
DLC Inc.	**11**
Ernst & Young LLP	**11**
Conway MacKenzie, Inc.	**10**
J H Cohn LLP	**10**

AIRA

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