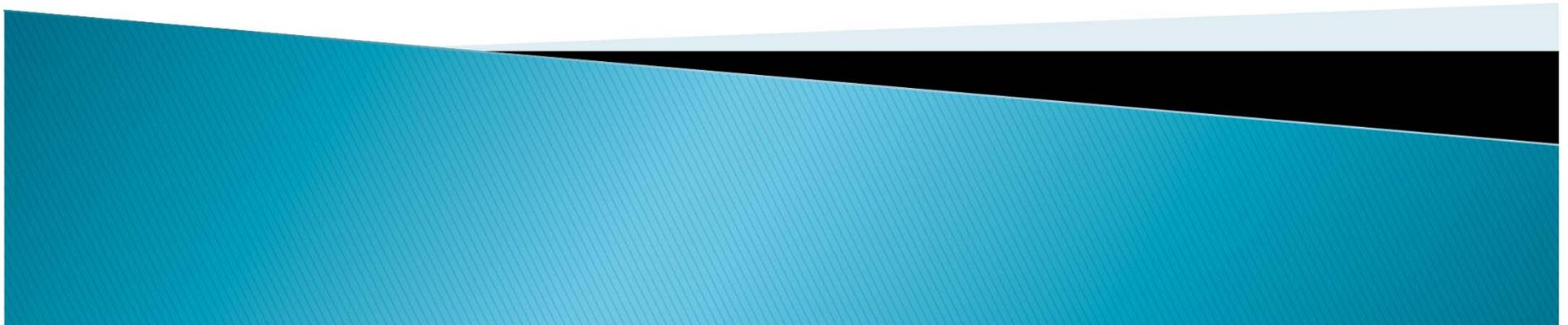


Bankruptcy Considerations

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Zone of Insolvency – Definition

- No Bright Line Test
- Period of financial distress between solvency and actual insolvency
- Balance sheet test: value of assets is less than liabilities
- Cash flow test: inability to meet obligations as they become due
- Unreasonably small capital test: insufficient capital to support financing



Zone of Insolvency – Fiduciary Duties

- Duty of Care
 - care of an ordinarily prudent person in like circumstances
- Duty of Loyalty
 - corporate interests above personal interests
- Duty of Good Faith
 - attention to potential risks of harm
- Duties of Ds & Os expand to include creditors
 - creditors previously protected by contract and other law
- Conclusion: maximize enterprise value of the company



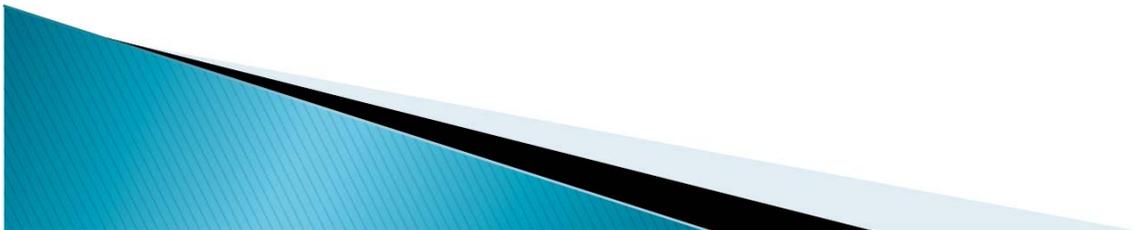
Creditor Options

- Cooperation
- Reduced credit terms
 - COD
 - CIA (cash in advance)
 - Deposits (for custom products or services)
- Collection action
 - Complaint (little reason to defend if amount owed)
 - Attachment
- Generally: 3 creditors with aggregate unsecured claims in excess of statutory amount (currently \$13,475)
- Liquidation (Chapter 7) or Reorganization (Chapter 11)



Involuntary Bankruptcy Petition

- Generally any 3 creditors with aggregate unsecured claims in excess of statutory amount (currently \$13,475)
- Liquidation (Chapter 7) or
- Reorganization (Chapter 11)



Out of Court Reorganization

- Equivalent of Chapter 11 reorganization
 - Meeting of Creditors
 - Formation of Committee of Creditors
 - Continued Business Operations
 - Development of Payment Plan
 - Negotiations with Creditors
 - Workout Agreement



Reorganization Pros & Cons

➤ Benefits

- Less expensive: professional fees, court costs
- Less Notoriety (customers, potential customers)
- Less time (most cases)

➤ Downsides

- No automatic stay: creditor attacks on bank accounts
- Need higher percentage of cooperation (only 2/3 in chapter 11)
- Not binding on dissenters
- No forum for dealing with unions
- Inability to force out shareholders



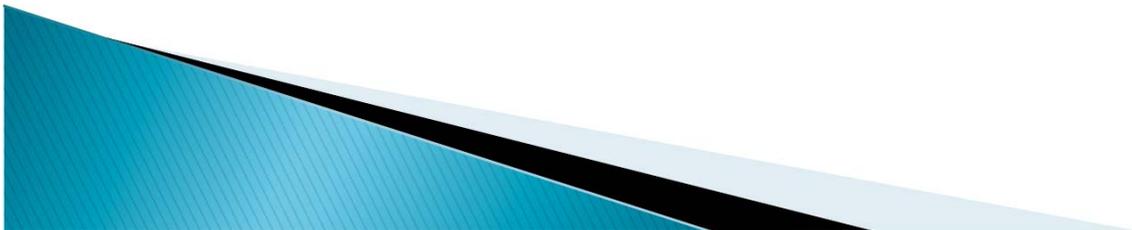
Director & Officer Liabilities

- Fiduciary Duties: Breaches
- Trust Fund Taxes: withheld payroll taxes, sales taxes (usually CFO)
- Personal Guarantees
- Separate Contracts
- Credit Cards
- Unpaid Wages, Severance, etc: not likely under state law, federal law unclear (check with employment law expert)



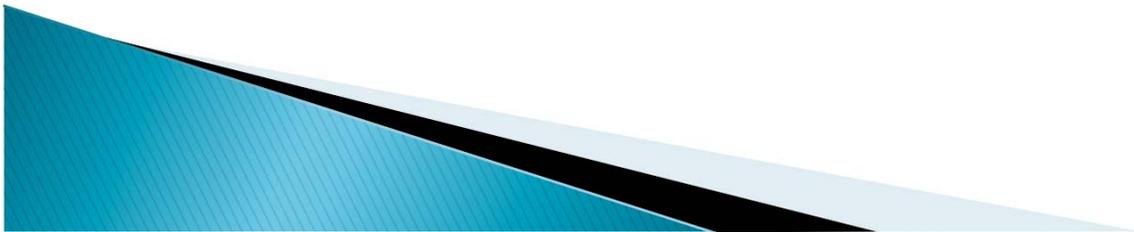
When to Retain Counsel

- Early
 - Zone of Insolvency
 - Cash Flow Projection
 - Balance Sheet test
- Midcourse
 - Recommendation of other professionals
- Latest
 - Collection lawsuit



Proactive Use of Insolvency

Partnership concept: “We have a problem and together we can fix it.”



Questions & Discussion

