AIRA Journal

Volume 34 No. 4

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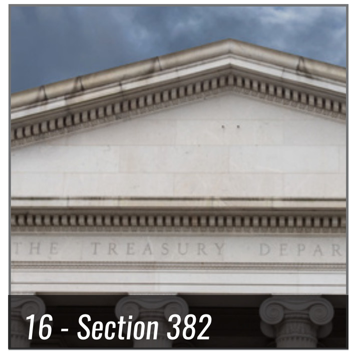
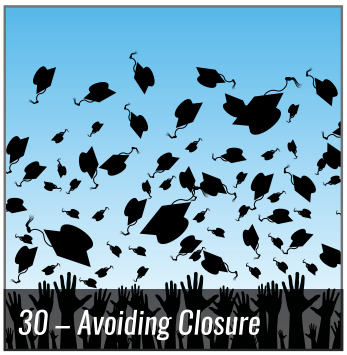




AIRA UPCOMING EVENTS

2022 Joint AIRA & NYIC Event

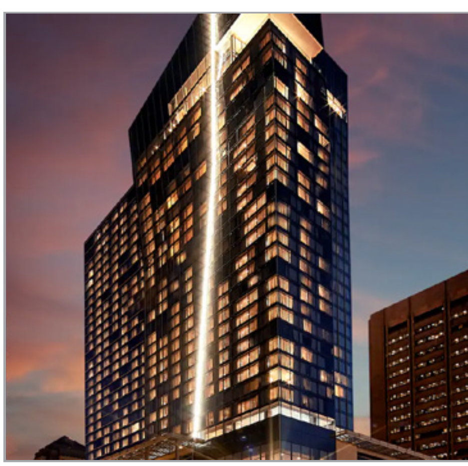
Wednesday, January 19, 2022 (11:00 AM - 2:30 PM) (EST)

LOCATION:

Arno Ristorante - 141 W. 38th Street, New York, NY 10018, United States

Gain financial and market insights with the New York Institute of Credit and AIRA as they present two panels of experts to help you navigate the current economic landscape.

More information and registration at www.instituteofcredit.org



38TH Annual Bankruptcy & Restructuring Conference

June 8-11, 2022

LOCATION:

Hilton Cleveland Downtown Hotel - Cleveland, OH

Save the date for AIRA's 38th Annual Conference ("AC22"). The conference is planned to be held in-person. More information and registration coming in early 2022!

From the Executive Director's Desk

JAMES M. LUKENDA, CIRA
AIRA

Thanksgiving is upon us, in fact, by the time this issue of the *AIRA Journal* is in your hands we will be looking ahead to the beginning of 2022. What a fine time to think about the things for which we have the opportunity to give thanks.

While a transition year for AIRA, 2020 was in many respects a lost year. How many times have any of you thought back about an event and could not quite remember whether the event occurred one or two or three years ago and then recalled you are forgetting about 2020 intervening in your time accounting. One of the things I see as a thankful circumstance is that 2021 has been a year where we have made great progress in getting back on track, in our personal lives, with our businesses, and from the perspective of the Association, with our ability to come together again as a turnaround and restructuring community in person.

Mike's president's letter refers to the upcoming 20th Annual Advanced Restructuring & Plan of Reorganization Conference. As I am writing this letter, the conference has just concluded and was a resounding success having allowed participants to attend either in person or virtually. As it was, about half of those in attendance met in an appropriately socially-distanced manner at the Union League Club in New York City while half attended on-line. The logistics of the day had me on edge, but it all came together famously with a program that comprised some of the best content ever.

The desire to meet, learn, and exchange ideas together is very basic. At the same time, we have all encountered situations where conflicting calls on our time prevent traveling to and attending a conference. What continues to be reinforced to me is that the broadest draw in educational programs going forward will be with hybrid presentations such as this conference, which will allow those that have the ability to meet and those that do not have the ability to nevertheless attend together.

My thanks go out to Sheryl Giugliano, Boris Steffen, and Judge Jerrold Poslusny, the conference co-chairs, and to our AIRA staff, Cheryl Campbell, Mike Stull, and Michele Michael for their effort in bringing the conference to its successful presentation.

As 2021 draws to a close, please remember that AIRA and New York Institute of Credit will again present a joint program in New York on Wednesday, January 19, 2022. The program benefits the AIRA Grant Newton Educational Endowment Fund (see www.aira.org) which provides an annual scholarship in accounting at Pepperdine University. Please remember to register and attend, and if your annual giving permits, please consider a direct, tax deductible, year-end contribution to the Fund.

Stay safe and stay well, and always look forward.

Jim

A Letter from AIRA's President

MICHAEL R. LASTOWSKI
Duane Morris LLP

Dear fellow AIRA members:

This has been an exciting, interesting and challenging year for all of us. As COVID-19 slowly recedes, we are all cautiously and slowly emerging from various degrees of COVID-19 lockdown. At AIRA, we continue to develop programs that provide value to our members while observing COVID-19 restrictions. We recently hosted a "hybrid" event.

The National Conference of Bankruptcy Judges held its annual conference in Indianapolis in October as a "hybrid" event, which gave participants the option of attending the conference "live" or "online." On Friday, October 8, 2021, AIRA hosted its annual NCBJ breakfast program and presented a panel on the United States Trustee Program's final rule on "Procedures for Completing Uniform Periodic Reports in Non-Small Business Cases Filed Under Chapter 11 of Title 11." The panelists included:

- Stephen B. Darr, CIRA, CDBV, Huron Consulting Group LLP (Moderator)
- William K. Harrington, United States Trustee for Regions 1 and 2
- Matthew Schwartz, CIRA, Bederson LLP
- Andrew R. Vara, United States Trustee for Regions 3 and 9

AIRA's annual Advanced Restructuring and Plan of Reorganization Conference will take place at the Union League Club in New York City. This will also be a "hybrid" event. The online option will give all of our members an opportunity to participate. In the post-COVID-19 world, hybrid events may well become the "new normal."

Our 38th Annual Conference will take place in Cleveland, OH from June 8 through June 11, 2022. You will be receiving more information about this conference in the weeks ahead, and I encourage all of you to attend. We are all hopeful that the pandemic will have receded considerably by the time of the annual conference and that the conference will provide all of us an opportunity to reconnect "in person."

I encourage each of you to take advantage of the many writing and speaking opportunities which AIRA provides. If you are interested in writing an article for the *AIRA Journal*, please reach out to me at mlastowski@duanemorris.com or to Boris Steffen of Province, Inc. at bsteffen@provincefirm.com. If you are interested in participating in any of our conferences, please reach out to one of our board members, all of whom are identified on our website.

Finally, AIRA continues to offer professional certification and educational courses online. AIRA's website provides information about our CPE offerings. CIRA and CDBV training programs are also available online. For further information, contact our Executive Director, Jim Lukenda, at jlukenda@aira.org.

Once again, I thank you for all your support and I hope to see you at future AIRA events.

Michael Lastowski

WILL ENERGY FUTURE HAVE THE ENERGY FOR FUTURE CLAIMANTS?

LAWRENCE FITZPATRICK, EDWIN J. HARRON, and SARA BETH A.R. KOHUT

The tension between companies looking for a "fresh start" through bankruptcy and the due process concerns associated with discharging latent-asbestos claims took on a new twist when the U.S. Court of Appeals for the Third Circuit approved a plan of reorganization that purported to address the due process rights of future asbestos claimants without utilizing section 524(g) of the U.S. Bankruptcy Code.[1] As the only statutory path available for a debtor to receive a permanent discharge of asbestos liabilities, including for future claims, section 524(g) permits a debtor to obtain that reprieve by establishing and funding a post-bankruptcy settlement trust to which the liabilities are channeled for resolution.

In *Energy Future Holdings Corporation*,[2] the Court of Appeals affirmed a confirmation order that permitted the debtor ("Energy Future") to discharge latent asbestos claims[3] without creating a litigation trust under section 524(g) of the Bankruptcy Code. The court approved the plan on the grounds that (1) the debtor engaged in an extensive notice program intended to inform asbestos claimants of the need to file their claims by a prescribed bar date,[4] and (2) the plan provided that certain unknown asbestos claimants who failed to file claims before the bar date would have the opportunity post-confirmation to seek reinstatement of their claims through motions under Federal Rule of Bankruptcy Procedure 3003(c)(3) ("Bankruptcy Rule 3003(c)(3)").[5] The Court of Appeals concluded that this combination of protections afforded due process to latent-asbestos claimants.[6]

Nevertheless, the Court of Appeals issued a warning to other debtors who may consider taking a similar path to Energy Future.[7] Although Energy Future's plan may satisfy the due process requirements of the Bankruptcy Code and the Constitution, the Court of Appeals indicated that it is a less desirable option because it could result in costly and unnecessary back end litigation for a debtor down the line.[8] As a result, future debtors that choose to follow this route forego final relief and leave open the door to face additional claims for asbestos liability.

While the Energy Future plan may technically provide for protection of the due process rights of future claimants, the opinion gives short shrift to the additional burden and uncertainty that claimants will face in having to seek reinstatement of their claims as time passes. As we will discuss, a subsequent decision on this matter illustrates that reinstatement may not be as simple as the Court of Appeals suggested. The opinion thus affirms that section 524(g) remains the best path for a debtor to

1 11 U.S.C. §524(g).

2 *See In re Energy Future Holdings Corp.*, 949 F.3d 806, 811 (3d Cir. 2020) ("The Bankruptcy Court determined that the discharge of such claims is permissible so long as the claimants receive an opportunity to reinstate their claims after the debtor's reorganization that comports with due process. We agree and therefore will affirm.").

3 The Third Circuit Court of Appeals described "manifested claimants" as those plaintiffs who have already developed an asbestos-related disease, while "latent claimants" means persons exposed to asbestos who are at risk for developing an asbestos-related disease. *Id*. at 811. We use "future claimants" to mean the latter. Notably, the Court of Appeals describes the appealing parties as latent claimants who did not file claims by the bar date, but subsequently developed mesothelioma. *Id*. at 815. True future claimants are unidentifiable because, while a debtor or a claimant may be able to establish a person was exposed to asbestos-containing products making illness likely, no one (not even the future claimant himself), can predict if or when a person will manifest an asbestos-related disease. To require latent claimants to assert a claim is to require them to act as "putative" claimants because they have a contingent claim until manifesting a compensable disease.

4 *Id.* at 822-23.

5 *Id.* at 823-25; Fed. R. Bankr. P. 3003(c)(3) ("The court shall fix and for cause shown may extend the time within which proofs of claim or interest may be filed. Notwithstanding the expiration of such time, a proof of claim may be filed to the extent and under the conditions stated in Rule 3002(c)(2), (c)(3), (c)(4), and (c)(6).").

6 *Energy Future*, 949 F.3d at 823-25.

7 *Id.* at 825 ("Indeed, this case serves as a cautionary tale for debtors attempting to circumvent § 524(g). The alternative route EFH has chosen for addressing its asbestos liability has produced a similar result as a § 524(g) trust—reimbursement for latent claimants who either filed proofs of claim or did not receive proper notice of the bar date—but with added and unnecessary back end litigation.").

8 *Id.*

achieve finality for its asbestos liability and to serve the interests of future claimants.

THE ATTEMPT TO BALANCE COMPETING INTERESTS

Bankruptcy Courts routinely confront the task of weighing the due process concerns of individuals with latent claims against a debtor's interest in a "fresh start." The latency period for manifestation of injuries caused by direct and even indirect[9] exposure to asbestos has presented a myriad of problems for courts trying to navigate the mismatch between bankruptcy laws and asbestos litigation.[10] In a standard bankruptcy case, the court will set a "bar date" for when claims against a debtor's estate must be filed. After the court confirms the debtor's plan, claims not timely filed by the "bar date" are discharged by the bankruptcy court.

However, this procedure presents due process issues for latent-asbestos claimants. The delayed manifestation of asbestos-related-disease symptoms, caused by firsthand or secondhand asbestos exposure, can result in the individual not knowing he or she even holds a claim for decades. Furthermore, if the individual does not hold a claim at the time the debtor goes through bankruptcy looking for a "fresh start," then there is no claim to be discharged.

After the successful creation of a litigation trust in the landmark case *In re Johns-Manville Corp.*,[11] in 1994, Congress enacted section 524(g) of the Bankruptcy Code to address these competing interests. Under section 524(g), the bankruptcy court appoints a legal representative to advocate for the interests of unknown, future claimants during the bankruptcy case.[12] In addition, the court issues an injunction that funnels all asbestos claims and obligations away from the reorganized entity and into a newly established settlement trust.[13] The claims channeled into the trust are processed and paid out on behalf of the debtor and

other specified parties entitled to protection under the injunction.

Section 524(g) has never been a cure-all. The tension between a debtor's "fresh start" and due process issues associated with discharging latent-asbestos claims is very much extant. Not every debtor can satisfy the strict criteria of section 524(g), leaving no recourse for individuals who manifest asbestos-related disease well after a plan of reorganization is confirmed.[14]

THIRD CIRCUIT PERMITS 524(G) CIRCUMVENTION

The Court of Appeals permitted Energy Future to bypass the 524(g) settlement trust by affirming the Delaware Bankruptcy Court's ruling, which determined the trust was not the only option to provide due process to unknown-future claimants.[15] The Delaware Bankruptcy Court, and subsequently the Court of Appeals, held that Energy Future's chapter 11 plan of reorganization comported with due process because the plan included notification procedures of the impending "bar date" and allowed unknown-future claimants the opportunity to reinstate their claims after the debtor's reorganization.[16]

Energy Future was a holding company with a portfolio of various energy properties.[17] Four of its subsidiaries, referred to by the Court of Appeals as the "asbestos debtors," were defunct entities in existence solely

9 We use "indirect" or "secondhand" exposure to mean individuals who did not themselves work with or around asbestos or asbestos-containing products but who were exposed to asbestos carried out of the work place by others. For example, a person may be indirectly exposed to asbestos by laundering the clothes of a family member or spending time around a family member wearing asbestos dust on their clothes.

10 *See In re Grossman's Inc.*, 607 F.3d 114, 122 (3d Cir. 2010) (en banc) ("[T]he determination [of] when a claim arises has [serious] due process implications."); *In re Cont'l Airlines*, 91 F.3d 553, 560, 565 (3d Cir. 1996) (en banc) (weighing the "public policy of affording finality to bankruptcy judgments [.]"); *In re Johns-Manville Corp.*, 68 B.R. 618, 624 (Bankr. S.D.N.Y. 1986) (channeling asbestos-related claims away from the debtor and funneling them into a trust to process and pay out claims), *aff'd*, 78 B.R. 407 (S.D.N.Y. 1987), *aff'd sub nom. Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2d Cir. 1988); *Kane*, 843 F.2d at 640-41 (stating that future claimants are "treated identically" to present claimants because the injunction funnels all claims to the trust despite future claimants not receiving creditor status under the reorganization plan).

11 68 B.R. 618 (Bankr. S.D.N.Y. 1986).

12 *Grossman's*, 607 F.3d at 126-27 (citing *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 234 n.45 (3d Cir. 2004).

13 *Id.*

14 *See In re Placid Oil Co.*, 753 F.3d 151, 158 n.7 (5th Cir. 2014) (finding that section 524(g) would not have applied to the debtor's bankruptcy since it had never been subjected to asbestos claims); *Grossman's*, 607 F.3d at 127 & n.13 (finding former debtor did not qualify for section 524(g) protection because it had yet to be named in any asbestos related lawsuits); *In re RailWorks Corp.*, 621 B.R. 635, 638-39 (Bankr. D. Md. 2020) (discharging an asbestos claimant's ability to pursue claims brought sixteen years after the debtor's bankruptcy, which did not include setting up a 524(g) channeling injunction, because the debtor had no knowledge of the claimant's identity and "[did] all that it could reasonably do to identify and provide notice to potential creditors.").

15 *Energy Future*, 949 F.3d at 822-25.

16 *Id.* at 814-15, 822-25.

17 *Id.* at 814.

Continued from p.7

because of their ongoing asbestos liability.[18] Energy Future and its subsidiaries, including the asbestos debtors, filed a voluntary chapter 11 petition.[19]

After filing for reorganization, Energy Future and Sempra Energy negotiated a merger which was scheduled to close after the Bankruptcy Court approved of Energy Future's reorganization plan.[20] The negotiated merger did not propose creating a 524(g) trust to manage the asbestos liability.[21] Instead, the plan would attempt to notify unknown-asbestos claimants to file their claims by the "bar date," and require future claimants who missed the "bar date" to seek reinstatement of their claims under Bankruptcy Rule 3003(c)(3).[22]

Thereafter, Energy Future went to great lengths to notify unknown asbestos claimants of the impending "bar date" and the need to file a proof of claim.[23] Specifically, Energy Future spent $2 million on a notice program to contact potential asbestos claimants.[24] This program included publishing notice in 7 consumer magazines, 226 local newspapers, 3 national newspapers, 43 Spanish-language newspapers, 11 union publications, and 5 internet outlets.[25]

As a result of Energy Future's expansive notification efforts, 10,000 latent claimants filed a proof of claim before the "bar date," assuring them the right to pursue a claim at a later time.[26] The plan also permitted unknown asbestos claimants to come forward after the bar date to attempt to have their claims reinstated through Bankruptcy Rule 3003(c)(3) motions.[27]

Under Bankruptcy Rule 3003(c)(3), the Bankruptcy Court "shall fix and for cause shown may extend the time within which proofs of claim or interest may be filed."[28] This subsection allows claimants to file after the bar date if they show "excusable neglect."[29] At the confirmation hearing for the debtor's plan of reorganization, the Bankruptcy Court ruled that future claimants' due process rights were protected because the notice procedures for the bar date combined with the reinstatement process under Bankruptcy Rule 3003(c)(3) was constitutionally sufficient.[30]

One group of Energy Future's creditors was unhappy with the reorganization plan: latent asbestos claimants who claimed their due process rights were violated under Third Circuit precedent in *Grossman's*.[31] In *Grossman's*, an individual was diagnosed with mesothelioma thirty years after her exposure to asbestos and died the following year.[32] The company allegedly responsible for exposing the woman to asbestos had reorganized through bankruptcy proceedings ten years before her diagnosis and lawsuit.[33] The Court of Appeals overruled prior precedent that had adopted the accrual test for when a latent claim arises and replaced it with a new test.[34] Under the new test, a claim is deemed to arise when an individual is exposed pre-petition to a product or conduct that causes injury giving rise to a "right to payment" under the Bankruptcy Code.[35] Accordingly, the claimant held a claim at the time of Grossman's bankruptcy case because she had been exposed pre-petition.[36]

Whether that claim was discharged, however, turned on the satisfaction of the claimant's due process rights, since her disease did not manifest until after confirmation.[37] The *Grossman's* court outlined a multi-factor test that courts should apply to determine whether the discharge of a claim comported with due process.[38] This test includes 5 factors: (1) whether the claimant was aware of their vulnerability based on exposure to asbestos, (2) whether the claimant was a known or unknown creditor, (3) whether the claimant received notice of the bar date, (4) whether the claimant had a colorable claim at the time of the bar date, and (5) whether the debtor could have established a settlement trust to address future claims.[39]

The Court of Appeals has since revisited the new test for latent claimants discussed in *Grossman's*. In *Wright v. Owens Corning*,[40] the court reasoned that "[n]ot extending our test to post-petition, but pre-confirmation, exposure would unnecessarily restrict the Bankruptcy Code's expansive treatment of 'claims' that we recognized in *Grossman's*."[41] As a result, the court reworked the new test for latent claimants to "include such exposure and h[e]ld that a claim arises when an individual is exposed pre-confirmation to a product or other conduct giving rise to an injury that underlies a 'right to payment' under the Code."[42]

The Delaware Bankruptcy Court disagreed with the latent-asbestos claimants that Energy Future's plan violated their due process rights and confirmed the plan

18 *Id.*
19 *Id.*
20 *Id.* at 813-14.
21 *Id.* at 814.
22 *Id.*
23 *Id.*
24 *Id.*
25 *Id.* at 822-23.
26 *Energy Future*, 949 F.3d at 811, 822.
27 *Id.* at 814.
28 *Id.* (citing Fed. R. Bankr. P. 3003(c)(3)).
29 *Id.* (citing *Pioneer Inv. Servs. Co.*, 507 U.S. at 388-89).
30 *Id.* at 814-15.
31 *Id.* at 814; *see Grossman's*, 607 F.3d at 127-28.
32 607 F.3d at 117-18.
33 *Id.*
34 *Id.* at 121, 125.
35 *Id.* at 125 (quoting 11 U.S.C. § 101(5)).
36 *Id.*
37 *Id.* at 117, 125-27.
38 *Id.* at 127-28.
39 *Id.*
40 679 F.3d 101 (3d Cir. 2012).
41 *Id.* at 107.
42 *Id.*

without the establishment of a settlement trust under section 524(g).[43] By doing so, it formally discharged all claims against the newly reorganized Energy Future that were not filed before the "bar date."[44] The latent-asbestos claimants then appealed.[45] The Delaware District Court dismissed the appeal, and the latent-asbestos claimants sought the Court of Appeals' review.[46]

The Court of Appeals did not determine the circumstances under which a debtor must establish a settlement trust under 524(g), but instead focused on whether Bankruptcy Rule 3003(c)(3) motions afford due process to unknown-future-asbestos claimants.[47] To show that the Bankruptcy Court's confirmation order was facially unconstitutional, the latent-asbestos claimants first needed to establish that they were deprived of an "individual interest that is encompassed within the Fourteenth Amendment's protection of life, liberty, or property."[48] Second, the latent-asbestos claimants had to show the absence of procedures to "provide due process of law."[49]

The Court of Appeals concluded that the latent asbestos claimants satisfied the first prong because they asserted a cognizable property interest within the protection of the Due Process Clause.[50] However, the latent asbestos claimants fell short on satisfying the second prong, because the combination of notice and hearing available under Energy Future's reorganization plan provided constitutionally adequate due process.[51]

The Court of Appeals found that the publication notice was sufficient to pass constitutional muster as to the latent claimants.[52] The debtor's pre-confirmation notice to unknown claimants resulted in 10,000 claims being filed by latent claimants by the "bar date."[53] The court then turned its focus to the post-confirmation reinstatement hearings which would be available to latent claimants through Bankruptcy Rule 3003(c)(3) motions.[54] Under the Energy Future plan, the Bankruptcy Court must accept late-filed proofs of claim for "cause shown," which may be fulfilled after concluding the "danger of prejudice to the debtor" is low; the claimant shows good "reason for the delay"; and the "length of the delay" does not have outsize "impact on [the] judicial

proceedings."[55] Based on these factors, the Court of Appeals found that deserving latent claimants would have the opportunity to have their claims reinstated so as not to deprive them of due process.[56]

In its analysis of the factors, the court first stated that all latent claimants would have the opportunity to show that reinstatement of their claims would pose no "danger of prejudice" to the debtors because the post-confirmation procedure was incorporated into the merger.[57] Second, latent claimants would have the chance to establish a "'reason for the delay' by showing that they would otherwise be deprived of due process under *Grossman's*."[58] Lastly, while the "length of delay" between the bar date and the latent claimants' Bankruptcy Rule 3003(c)(3) motions would be substantial, latent claimants would not be precluded from arguing that the delay had "no impact" on the debtor's bankruptcy proceedings because those proceedings concluded with the confirmation order.[59] As a result, the Court of Appeals found that the reinstatement process under Bankruptcy Rule 3003(c)(3) afforded latent claimants due process.

Although it decried this process as resulting in litigation on the back end for the debtor, the Court of Appeals downplayed the burden future claimants would face by suggesting they would merely have to file an affidavit covering the factors under Bankruptcy Rule 3003(c)(3) for reinstatement. The Court of Appeals did not analyze the likely efforts the reorganized entity would take to challenge the reinstatement of claims, or whether the

43 *Id.* at 814-15.
44 *Id.* at 815.
45 *Id.*
46 *Id.*
47 *Id*. at 822-25.
48 *Id.* at 822 (quoting *Hill v. Borough of Kutztown*, 455 F.3d 225, 234 (3d Cir. 2006)).
49 *Id.*
50 *Id.*
51 *Id.*
52 *Id.* at 822-23.
53 *Id.* at 814, 822-23.
54 *Id.* at 823.

55 *Id.* (first quoting Fed. R. Bankr. P. 3003(c)(3); and then quoting *Pioneer Inv. Servs. Co.*, 507 U.S. at 389, 395 (applying the "excusable neglect" standard of Fed. R. Bankr. P. 9006 to Fed. R. Bankr. P. 3003(c)(3))).
56 *Id.*
57 *Id.*
58 *Id.*
59 *Id.* at 824.

Continued from p.9

reorganized entity would even have any resources available at the time of reinstatement to satisfy a claim. Moreover, at some point, the balance of the equities of the Bankruptcy Rule 3003(c)(3) factors (such as the length of delay between the bar date and the reinstatement motion) will likely start to swing in favor of the debtor. In turn, this pendulum would make it more difficult for future claimants to find recourse.

CLAIMANTS UNSUCCESSFULLY TEST THE REINSTATEMENT PROCESS

The reinstatement process under Bankruptcy Rule 3003(c)(3) was tested just a few months after the Court of Appeals' decision, with the Bankruptcy Court rejecting certain claimants' motion for reinstatement. But considering the test came from the claimants who brought the appeal in Energy Future and that the court's analysis was highly fact specific, this rejection may not be indicative of how well reinstatement attempts will fare when brought by other latent claimants who manifest disease after plan confirmation.

In August 2020, the Delaware Bankruptcy Court considered and denied the motions of two claimants who sought to file proofs of claims after the bar date.[60] Following the establishment of the bar date, the claimants were diagnosed with asbestos-related illnesses and actively participated in the plan and confirmation process related to Energy Future's reorganization plan.[61] This participation included a role in the appeal of the confirmation order to the Court of Appeals, where Energy Future's plan was ultimately affirmed.[62]

Following confirmation of Energy Future's plan, the claimants filed their motions for proofs of claim after the bar date and claimed that they never received notice of the bar date and that they did not have due process as a result.[63] The Bankruptcy Court disagreed with the claimants.[64] First, the court found that the notice of the bar date was adequate for the claimants and that the Court of Appeals had specifically held that publication notice may be sufficient for these cases.[65]

These claimants were also in a unique circumstance.[66] They had participated in the cases and were represented by law firms which had "actively participated" in the objection and formation of the notice plan for un-manifested asbestos claimants.[67]

Second, the court considered the *Pioneer* factors[68] and determined that they weighed against a finding of excusable neglect.[69] Although the prejudice to the

60 *In re Energy Future Holdings Corp.*, 619 B.R. 99, 102-03 (Bankr. D. Del. 2020).
61 *Id.*
62 *Id.*

63 *Id.* at 102-03, 108.
64 *Id.* at 108-09.
65 *Id.* at 108 (citing *In re Energy Future Corp.*, 522 B.R. 520, 537 (Bankr. D. Del. 2015)).
66 *Id.*
67 *Id.*
68 *Pioneer*, 507 U.S. at 400 ("[T]he danger of prejudice to the debtor, the length of the delay and its potential impact on judicial proceedings, the reason for the delay, . . . and whether the movant acted in good faith.").
69 *Energy Future* 619 B.R. at 119.

ABOUT THE AUTHORS

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Lawrence Fitzpatrick has more than 30 years of experience in handling asbestos-related claims and issues, including serving as the head of two asbestos-claims resolution facilities. He currently serves as the sole trustee for the Met-Coil TCE PI Settlement Trust. Additionally, he serves as the legal representative for future claimants in two pending asbestos bankruptcy cases and in connection with eight asbestos personal injury settlement trusts established through bankruptcy cases under Section 524(g) of the U.S. Bankruptcy Code.

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debtors would be minimal, the length of delay, impact on judicial proceedings and lack of good faith all weighed heavily in favor of the finding that the neglect in missing the bar date was not excusable.[70] Finally, the court found that the claimants' "notices of intent" were not informal proofs of claim and ultimately denied both motions.[71]

PROCEED WITH CAUTION

In concluding its opinion, the Court of Appeals cautioned future debtors against the reinstatement procedure espoused in the Energy Future plan because of its potential for causing greater costs and inefficiency than a section 524(g) plan.[72] Indeed, Energy Future's plan means the reorganized debtor will always have the specter of future asbestos claims hanging over it when it, alternatively, could have resolved these claims with certainty under section 524(g). The 10,000 claims for future relief that were filed by the bar date suggests that Energy Future may have to spend significant resources to address those claims when presented and, potentially, a significant amount of claimants seeking reinstatement under Bankruptcy Rule 3003(c)(3).

70 *Id.* at 110-119.
71 *Id.* at 120.
72 *Energy Future*, 949 F.3d at 825.

Moreover, just as section 524(g) is not available to all debtors with asbestos liability, Bankruptcy Rule 3003(c)(3) reinstatement will not be a feasible resolution for all asbestos-laden debtors. Section 524(g) sets forth criteria intended to satisfy due process concerns. The Energy Future model—with its robust, multi-million dollar notice program and reinstatement procedures with, potentially, high back-end costs—may be unattainable for other debtors with limited means and few prospects post-confirmation for long-term, viable operations.

Although not a panacea, section 524(g) is still the best option for future asbestos claimants. A settlement trust established under section 524(g) not only provides a non-litigious way for claimants to present a claim when it becomes ripe in the future but also provides greater assurance that funding will be available to pay such claims because adequate funding and cautious governing controls are prerequisites for confirmation under section 524(g). The Energy Future model remains to be further tested, but more than 25 years of precedent demonstrates that the section 524(g) model has been highly successful in providing long-term recourse and compensation for future claimants. The Court of Appeals' decision should be the exception, not the norm, to address the due process rights of latent-asbestos claimants.

EVALUATING AND NEGOTIATING LITIGATION FINANCE ALTERNATIVES FOR POST-CONFIRMATION RECOVERY ACTIONS

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How many times have you seen this scenario? After months of negotiating, the Debtor, Secured Lenders, and Unsecured Creditors, Mezzanine Lenders, and Bondholders reach a consensual settlement that the Debtors will propose in the form of a Chapter 11 Plan for which they will seek confirmation. Valid claims of Secured Lenders and Mezzanine Lenders encumber all tangible and intangible properties of the Debtors, so the only recovery value available to Unsecured Creditors is the carveout granted in the negotiations by the Secured and Mezzanine, which comprises the Debtor's basket of recovery actions for preference, fraudulent conveyance, insider transactions, and other claims, plus a slice of cash to fund pursuit of those claims. Evaluating those claims often plays second fiddle to the prime objective of negotiating the consensual restructuring, and it is not uncommon for the negotiated slice of cash to be a little short when it comes to adequate funding of litigation services that will maximize the Unsecured Creditors' recoveries.

Plaintiffs' counsels being considered for various components in the basket of recovery actions may or may not want to pursue the case on a contingent fee basis, and, even if they are so willing, is a standard contingent fee arrangement in the best interest of creditors?

Not to mention, how often have many readers of this publication – financial experts and attorneys providing post-confirmation legal services – been approached by Creditors Committees or Post-Confirmation Trustees for potential retention to wrap up the estate and pursue recovery actions, only to find that funds set aside to cover professional fees are thin at best and – at worst – inadequate to cover the number of professional hours requisite to winning the case.

We have all at least thought about litigation finance as a cure for these problems, and this article provides a how-to guide for understanding the process, due diligence, pricing, and contractual arrangements you may need to consider.

LITIGATION FINANCING CAN HELP TO SHIFT RISKS, MANAGE COSTS, AND UNLOCK VALUE

In 2021, worldwide legal services are expected to reach US$ 767 billion,[1] with lawyers in the United States accounting for almost half of the global market,[2] or roughly $383 billion. Of that, litigation accounts for approximately $200 billion. In the U.S., litigation financing has only recently begun to gain market adoption. In 2019, prior to the COVID pandemic, the level of market penetration in the Australian and UK markets was somewhere between 3 percent and 7 percent, whereas in the U.S. it was only between 0.5 percent and 2 percent.[3] However, more and more lawyers and their clients are discovering the main benefits of litigation financing – the ability to more effectively manage their costs, shift risks, and pursue claims that but for litigation funding would have been cost-prohibitive.

In the U.S., economic forces are propelling the expansion of litigation finance, although regulation still may bar its usage in some states. The economic forces include competitive pressures on U.S.-based international law firms by non-U.S.-based international law firms that can avail themselves of such funding, the effects of the recent global recession, and the convergence of long-standing trends relating to law-firm finance. In 2019, the U.S. had 41 funds principally involved in providing litigation finance. That number grew to 46 in 2020 with a total AUM of $11.3 billion.[4] In the first half of 2020, in the midst of the Pandemic, litigation capital funds raised over $1 billion, and may raise even more in 2021.

In the early decades of litigation finance, single-case funding of plaintiffs' litigation costs dominated the landscape, with funders performing extensive due

[1] Statista, *Size of the legal services market worldwide from 2015 to 2023,* https://www.statista.com/statistics/605125/size-of-the-global-legal-services-market/.
[2] Statista, *Share of the global legal services market in 2017, by region or country*, https://www/statista.com/statistics/605510/distribution-of-the-global-legal-services-market/; Statista, *Size of the legal services market in the U.S. by category 2019-2020*, https://statista.com/statistics/741393/size-of-the-legal-services-market-by-category-us/.
[3] *FY19 Results Presentation*, LITIGATION CAPITAL MANAGEMENT LIMITED 19 (Sept. 2019), https://www.lcmfinance.com/wp-content/uploads/2019/10/LCM-FY19-Results-Presentation_FINAL-V1-1.pdf.
[4] Westfleet Advisors, *The Westfleet Insider 2020 Litigation Finance Market Report*, 4.

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diligence and often employing sophisticated algorithms to measure possible resolution milestones, ultimate outcomes, and cost scenarios. Buoyed by investment success rates often exceeding 80 percent and significant capital raised by the industry, over the last decade litigation funders have been extending their footprints to address both portfolio funding and defense-side finance. These trends make litigation funding a possible option for broader and broader segments of the legal services marketplace.

This article contains observations of what to expect when you consider litigation funding for commercial litigation: shopping, due diligence, timing, pricing, and need to seek competent legal advice.

FUNDING OVERVIEW

Litigation financing can be defined as a transaction in which a third party, which is neither a party to a legal claim nor their legal counsel, provides funding to a party to a legal claim (or their legal counsel) in exchange for a financial interest in the outcome of the legal claim. Funds advanced are generally structured as nonrecourse investments, with repayment contingent upon a successful outcome of the underlying legal claim. If the case fails, the borrower owes nothing to the litigation funder.[5]

Litigation financing is typically used in two main types of claims: commercial and consumer. This article focuses on commercial claims funding. Recent U.S. cases see litigation financing being used in the bankruptcy cases category of commercial claims, with funders making investments in post-confirmation recovery actions against insiders and other parties who received preferential payments or proceeds of transactions that were so over-leveraged to be treated as fraudulent.

Commercial claims eligible for litigation finance consist of business-to-business disputes with substantial amounts in controversy (generally more than $10 million). Candidates for a commercial litigation finance transaction often involve large (relative to the party's perspective) legal and expert budgets, where the case is strong and where a successful outcome has significant financial upside. Many case parties will not seek litigation finance until past the "motion practice" stage. This delay makes financial common sense for the borrowing party, because average monthly costs in the motion practice stage typically are much less than the trial stage, and if the dispositive motions are resolved in the borrower's favor, there is much lower risk to the litigation funder and hence a lower cost of funds to the borrower.

Investment criteria for commercial cases often include:

- Financing requests exceeding $500,000 to $1,000,000;
- Expected settlement claim values in excess of $10,000,000; and
- Ratio of claim values to financing requests in excess of 5:1 (and for most funders 10:1).[6]

Recent anecdotal data indicates expanding funding appetite for smaller levels of legal and expert budgets during recent years, so that a $250,000 funding level might be attractive to some market participants.

As part of due diligence, the litigation funder will seek assurance that the legal and expert team is the best and the brightest, with a significant track record of wins against "big guns." Although the litigation finance company will evaluate the reasonableness of litigation budgets, the key focus should be investing the right amount to resolve the case at higher ranges of favorable outcomes. An excessively cost-conscious client may send a message of low confidence in the merits of the case. Should the client seek a structure that ensures it some reasonable cash for a case resolving at lower recovery levels, this issue can often be bridged by negotiating with party counsel for hourly rate concessions, which can be earned back at a premium upon achievement of higher ranges of favorable outcomes.

BROADENING MARKETPLACE

Attracted by returns correlated neither with the market nor with individual case portfolio components, and fueled by low marketplace interest rates, the litigation finance market has grown to a more than $11 billion industry. To put all that money to work, funders have expanded their footprints to provide portfolio and defense-side finance, as well as provide flexible arrangements that share risks and rewards on a bespoke basis among client, legal counsel, and funder.

[5] *Guide to Litigation Financing*, WESTFLEET ADVISORS 3, https://www.westfleetadvisors.com/wp-content/uploads/2018/11/WA-Guide-to-Litigation-Financing.pdf.

[6] *Guide to Litigation Financing,* at 6.

Portfolio funding has become a core focus of the litigation funding industry over the last decade. In portfolio finance, the funder invests in a group of claims held by a common plaintiff or prosecuted by the same law firm. This provides the funder with three advantages:

1. Putting more capital to work;
2. Gaining experience and qualitative comfort with the borrower, which reduces due diligence costs per dollar invested; and
3. Reducing risk, by offsetting winners against losers and measuring compensation based on the overall portfolio result.

From the law firm's perspective, portfolio funding may allow opening new offices or material practice growth while avoiding capital calls on partners. For example, the law firm could grow a book of contingency fee cases without the financial risk of internally funding increased payroll and office rent. From the plaintiff-client's perspective, portfolio finance can reduce funding costs and can evolve the legal department from a cost-center into a profit-center for corporate budgeting purposes. Portfolio finance may also allow the plaintiff-client to free up capital and fund business growth or pay off bank and other creditors, by selling and monetizing material interests in pending litigation. A recent example is the Century 21 Department Stores chain, which sold an over $175 million COVID business interruption claim against insurers and used the proceeds to fund payments to creditors.[7]

Defense-side litigation funding normally requires that a valuable asset – such as a revenue-producing or cost-reducing contract – be at risk in the litigation. For example, perhaps a long-term supply contract calls for per unit revenues materially exceeding current market, and the plaintiff is seeking to avoid the contract by asserting a technical breach. A defense-side litigation funding arrangement might call for the litigation funder to receive return of capital plus its contractual return out of post-litigation profits from the asset. Like all litigation funding, the funds are advanced on a nonrecourse basis, so the defendant owes nothing to the litigation funder should it lose the case.

Alternatively, the defendant and the litigation funder can agree on a definition of "success" in the case. For example, say the defendant is being sued for $50 million, and the defendant and the litigation funder agree that success is a resolution of the case for less than $30 million. If costs of the defense are $2 million, the litigation funder might be entitled to the first $6 million of savings below the $30 million level, plus 33 percent of any savings beyond the first $6 million and subject to a cap.

Defense-side finance aligns risk profiles by shifting risk from the risk-averse defendant, who may be facing a once-in-a-lifetime substantial legal threat, to a well-capitalized litigation funder, who is pooling the risk over a large number of cases the outcomes of which are generally non-correlated.

Finally, in any transaction – especially litigation funding – there will be different perceptions of risks and potential outcomes. The good news is that the amount of capital raised and not yet deployed makes litigation finance a little bit of a buyer's market in which structures and compensation can be tailored on a bespoke basis. The client, the law firm, and the funder have some flexibility to tailor the transaction terms and amounts financed to fit their respective perceptions of risks and rewards, provided they are able to attract the funder with a sufficient return to compensate for the funder's perception of risk. For example, a law firm may want the upside of a contingent fee, but does not want to go out-of-pocket for expert and other costs – they can seek to fund only the expert and other costs.

KEY ROLE OF THE CLIENT'S LAWYER

Most marketing outreach by litigation funders is through outside counsel. Outside counsel will address the following legal objectives in dealings with the litigation funder:

1. Protect against disclosing the existence and terms of litigation funding;
2. Avoid discovery of documents and case issues disclosed by counsel to the prospective funder;
3. Protect against discovery of the litigation funder's analysis of the merits and hazards of litigation;
4. Avoid adverse impacts on the attorney-client privilege and the work-product doctrine; and
5. Align the economic interests of the funder with those of the client and its outside counsel.

In most jurisdictions, after analyzing the law the lawyers can accomplish their nondisclosure and discovery objectives by using signed consulting and nondisclosure agreements. Most courts are unlikely to compel disclosure of funding documents or merits and hazards analysis, characterizing these as protected under work product and nondisclosed consulting expert legal principles.

An appropriate funding agreement (agreements that to date have been upheld by a majority of courts) will define the litigation funder's role, giving the funder appropriate information for investment management but leaving ultimate decisions about litigation strategies and settlement to the client, based on legal advice

[7] *See*, Order Authorizing and Approving (A) Sale of Insurance Action Interest Free and Clear of Liens, Claims and Encumbrances, and (B) Settlement with Gindi Parties, *In re Century 21 Department Store, LLC*, No. 20-12097 (S.D.N.Y., Dec. 28, 2020).

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Exhibit 1: Leading Litigation Funding Companies

#	Company	Ownership	Founded	AUM (Mil)	Employees	Offices
1	Omni Bridgeway (formerly IMF Bentham)	Public	2001	$2,200	101	San Francisco, Los Angeles, Houston, New York, Toronto, Montreal, London, Hong Kong, Singapore, Perth, Adelaide, Melbourne, Sydney, Brisbane
2	Burford	Public	2009	$2,900	125	New York, London, Chicago, Washington, Singapore, Hong Kong, Sydney, Los Angeles, San Diego, Scarborough, Guernsey, Dublin, Amsterdam
3	Therium Capital Management	Private	2009	$1,100	20	London, Dusseldorf, Oslo, New York, Jersey, Melbourne
4	Harbor Litigation Funding	Private	2007	$1,541	29	London, Hong Kong
5	Longford Capital	Private	2011	$1,000	16	Chicago, Dallas
6	Brickell Key Asset Management (merged with Juridica Asset Management)	Private	2007	$400	5	London, Sydney, Melbourne, Toronto, Miami
7	Augusta Ventures	Private	2013	£585	85	London, Sydney, Melbourne, Toronto
8	Validity finance	Private	2018	$250	13	New York, Chicago, Houston, Tel Aviv
9	Parabellum Capital	Private	2012	$666	18	New York
10	Legalist	Private	2016	$140	15	Las Vegas
11	Vannin Capital (acquired by Fortress Investment Group)	Private	2010	$1,000+	32	London, Paris, Sydney, Isle of Man, Jersey
12	Lake Whillans	Private	2013	$107	7	New York, Dallas
13	Baker Street Funding	Private	2018		2	New York, Naples, FL
14	Statera Capital	Private	2018		5	Chicago
15	LexShares	Private	2014		13	Boston, New York
16	Woodsford Litigation Funding	Private	2010		20	London, Philadelphia, Singapore, Tel Aviv, Brisbane
17	Pravati Capital	Private	2013		19	Scottsdale, Los Angeles, Dallas, New York
18	Litigation Capital Management	Public	1989	$416	19	Sydney, Melbourne, Brisbane, London, Singapore
19	Manolete Partners	Public	2009	£18	12	London

from the lawyer. For regulatory reasons and alignment reasons, the funding agreement is passive, giving the funder no contractual say-so in litigation strategy. However, the funder has highly sophisticated in-house counsel, and their input may be helpful.

Many litigation funding agreements call for budgets and funding in stages, and there may be conditions on which funding can be curtailed or suspended (although as discussed hereinbelow, bankruptcy courts are reluctant to approve funding agreements that give the funder too much control). Legal counsel will assist the client in negotiating these terms and conditions, with the understanding that there is a tradeoff between the level of risk assumed by the litigation funder versus the rate of return sufficient to induce the litigation funder to make the financial commitment. Funders generally require periodic updates on the status of their investment, although as part of detailed pre-commitment due diligence the funders get very comfortable with the lawyer's and the client's business judgment pertaining to the case or the case portfolio.

Due to legal restrictions on fee sharing, the majority of litigation funding contracts are between the client and the litigation funder. Contracts typically fund in tranches and allow the attorney and trial vendors such as experts to draw fees from funding held in counsel's trust account, following a short timetable for invoice review and approval.

There are issues in some jurisdictions regarding conflicts of interest when an attorney participates in negotiating a contract that enables the client to fund that attorney's past and future fees, so some attorneys will advise their clients to seek separate counsel for the negotiation with the funder.

SHOPPING FOR LITIGATION FUNDING

Litigation finance is a growing area, with new market participants raising capital and entering the field, as well as hedge funds expanding their investment footprints to address litigation funding. Exhibit 1 above is a summary of leading litigation funding companies.

Much information can be obtained from funder websites regarding case appetite and investment criteria, including principal industries or legal issues in which the fund specializes, and min-max capital deployment ranges. Most funds have extensive legal talent in-house, with expertise in specific industries and issues on which the fund concentrates its investments. For example, some funds avoid investment in failed auditor litigation whereas others will finance recovery actions against auditing firms. Obtaining and understanding this information can help the client make the shopping process more efficient.

In terms of timing, it is always best to plan and begin shopping early, to avoid time constraints that can be imposed by scheduling orders. The litigation funding process is not a quick process, covering the following six stages:

1. The process commences when a litigation funding company enters into a non-disclosure agreement with a prospective litigant. The NDA ensures that confidentiality of the case and the funding terms that may be agreed between the parties are maintained. The non-disclosure agreement is also likely to be worded to ensure that, as far as possible, attorney-client privilege and the work product protection are preserved over the documents that are shared between the parties.[8]
2. The litigation funding company is likely to ask the litigant and their counsel for documents to enable them to undertake a full analysis of the claim. The funder must evaluate a single piece of litigation based on legal risk, counterparty risk, judiciary risk, and plaintiff risk. Setting up the confidential data room in advance is a good idea.[9]
3. A professional funder will always undertake a detailed review of the case they are being asked to fund. As a first step, the funder is likely to consider whether the claim fits its organization's investment criteria. This varies significantly between funders. The prospective funder may also need time to retain outside consultants, e.g., to evaluate the likelihood of the court agreeing with expert testimony. The shopping process can be lengthened if the *consulting expert* has a predisposition based on his or her regular expert work on the opposite side of an issue.
4. Assuming the case meets the funder's investment criteria, the usual next step is for the funder to offer terms to the litigant in the form of a term sheet. This term sheet will include the terms on which the funder is prepared to fund the claim based on their overall assessment of it, including, perhaps most importantly, the budgeted costs of litigating the claim. The terms offered are likely to be presented as either a percent of the damages return received by the litigant or a multiple of the money invested by the funder.

   The term sheet will also include a period of exclusivity, during which, once the terms are agreed, the claimant is prohibited from approaching or speaking to any other funders. This exclusivity period will vary depending on the complexity of the case but is likely to be between 28 and 45 days. It is important to have socialized the opportunity with more than one litigation funder before negotiating the term sheet, to help guide the negotiating give and take by getting an overall understanding of the extent to which there will be alternative funders. However, the objective of litigation funders is to deploy capital to fund attractive cases. These are sophisticated lenders and terms proposed are generally within market ranges for the risk profile of the subject case.
5. During the exclusivity period set out in the term sheet, the funder will, at its own cost, obtain a legal opinion verifying the funder's analysis of the claim. If there are particular concerns about other elements of the claim, for example, the likely damages return, the funder may also instruct an economist or accountant to verify the assessment that has been made.
6. Presuming no unexpected issues are raised during the external review of the claim, the funder will seek to agree upon a formal funding agreement with the litigant. Once the detailed terms of this formal agreement are finalized, the funder will present the claim for funding to their investment committee. If all of the steps set out at Stages 1—5 above are satisfied, it is likely that the case will be approved for funding by the funder's investment committee. However, it may be that the investment committee requires certain conditions precedent to be met (these can vary on a case-by-case basis) before the first draw-down of funds is made available.

Financing costs are analyzed and negotiated on a case-by-case basis and are based upon a variety of factors, including a capital provider's perceived risk of an adverse outcome and length of time the financing may be outstanding. Since capital providers assume the risk of an adverse outcome, their profits on successful financings must be sufficient to offset their losses on unsuccessful ones plus their costs of marketing and costs of diligence on cases on which funding does not close. Many funds reject more than 90 percent of cases presented to them, and there is a diligence cost associated with the rejection. Clients and their counsel should bear this 90 percent (plus) rejection rate in mind when planning the duration of the shopping phase.

Capital providers strive to generate private equity-like returns (i.e., ≥20 percent annualized returns) for their investors. In order to achieve these returns, the capital provider would seek to achieve financing returns

[8] Rosemary Ioannou, *Litigation Funding Process,* VANNIN 1, https://vannin.com/press/pdfs/LexisPSL_Litigation_funding_process'.pdf.

[9] Edward Truant, *The Importance of Diversification in Commercial Litigation Finance,* LITIGATION FINANCE JOURNAL (Dec. 27, 2017), https://litigationfinancejournal.com/litfin101/importance-diversification-commercial-litigation-finance/.

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Exhibit 2: Performance of Litigation Funders with Larger Due Diligence and Marketing Staffs

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Invested Capital:									
Burford	0.57x	0.52x	0.60x	0.70x	0.60x	0.76x	0.85x	0.88x	0.92x
IMF Bent/OmniBrdgwy	4.10x	3.90x	3.73x	2.58x	1.55x	1.60x	1.50x	unknown	unknown
Litigation Cap Mgt	2.80x	-0.44x	2.10x	1.98x	1.00x	2.76x	1.38x	1.35x	1.34x
Average Investment Length (in years):									
Burford	2.3	1.9	2.1	2.0	1.6	1.5	1.8	1.7	1.9
IMF Bent/OmniBrdgwy	2.3	2.3	2.3	2.4	2.4	2.6	2.6	2.6	2.2
Litigation Cap Mgt	unknown	unknown	unknown	unknown	unknown	2.2	2.3	unknown	unknown
Success Rate:									
Burford	69%	75%	75%	79%	81%	84%	86%	unknown	unknown
IMF Bent/OmniBrdgwy	77%	73%	74%	74%	73%	91%	90%	89%	80%
Litigation Cap Mgt	unknown	unknown	unknown	unknown	unknown	79%	88%	87%	unknown

of $1 million to $3 million for a $1 million financing commitment, depending upon the risk of the case. For example, if the defendant were to settle with the plaintiff for a $20 million gross recovery, and the funded costs of litigation were $1 million, the funded costs plus return to the financer could range generally between $2 million to $4 million (10 percent to 20 percent of the gross recovery).

From the litigation party's or the law firm's perspective, the costs of the financing are best viewed as a reduction in the upside (or the potential substantial savings) in a successful resolution of the claim. And, of course, a funder receives nothing in cases that are unsuccessful due to the nonrecourse nature of the litigation financing. For cases adjudicated or settled with a partial finding in favor of the party, actual payment to the funder may be less than projected.

A funder typically charges its capital partners an annual management fee based on the capital invested or committed to the fund (usually 1-2 percent) plus a performance fee equal to a percentage (usually 20 percent) of the profits earned by investing the fund's capital. Most funds' organizational documents have clear parameters that dictate the types of investments the general partner may make with the fund's assets, often placing restrictions on the case types, case stages, or financing structures in which the fund may invest. Also, a fund usually has a limited deployment period in which the fund's capital may be invested in new financing opportunities, after which time the provider begins returning investors' capital as the cases that were financed mature. Financing providers often feel significant pressure to deploy capital in a new fund and then experience diminished appetite for new transactions as they approach full deployment.

Returns are typically negotiated as a multiple of capital invested or committed, a percent of the gross or net recovery, an interest rate or internal rate of return, or any combination of these factors. Portfolios (as contrasted with single case funding) have less risk due to cross-collateralization, and accordingly tend to have lower returns to the funder and thus lower costs to the borrower. The higher the perceived risk – which is generally based upon merits, jurisdiction, adversary, opposing counsel, and collectability – the greater return a funder will seek to negotiate. A funder's negotiated return may also increase over time to account for duration risk. Following the funder's initial recovery, the next levels in the waterfall may be apportioned on a complete or percentage basis to any of the funder, the litigant, and the law firm. Some claimholders may also negotiate the right to pre-pay a funder's return.

PRICING

Exhibit 2 provides published cumulative performance statistics for publicly reporting litigation funders. These publicly reporting entities are among the larger funders in the marketplace, with larger internal due diligence and marketing staffs.

Using an 80 percent success rate and assuming no material average size differentials between successful versus unsuccessful cases yields the illustrative pricing data shown in Exhibit 3 on the next page.

In recent years, it's not uncommon to see a partial cash-pay, partial contingent fee structure for legal counsel, with counsel's cash portion plus expert costs funded

Exhibit 3: Illustrative Pricing Data

Average ROIC	0.90x	1.20x	1.50x
Add Capital Invested	1.0x	1.0x	1.0x
Total investment plus return for average case	1.9x	2.2x	2.5x
Divide by success ratio	÷80%	÷80%	÷80%
Winners only ROIC plus Capital Invested	2.4x	2.8x	3.1x
Amount owed for each nonrecourse dollar borrowed	$2.40	$2.80	$3.10
Funder's internal rate of return, assuming 3 equal draws on months 1, 13 and 25, with 25-month average case duration, additional 12 months to monetize case resolution, 10% of AUM per annum cost structure	21%	30%	36%

by litigation finance. This captures some of the upside of a full contingent fee arrangement for plaintiff's counsel, but also spreads risk over the litigation funders portfolio. For example, this could ensure the law firm covered its payroll costs and overhead attributable to a large contingent fee case, while keeping the contingent portion for partner compensation in event of successful outcome.

Exhibit 4 is a sample comparison, with break points, of a simple 40 percent contingent fee arrangement to a typical litigation funding arrangement.

Clients are advised to test the waters for the three alternatives – all litigation funding vs all contingent fee vs some of each – to see which is the most cost effective.

POTENTIAL FUNDING LIMITATIONS

The following factors present a combination of marketplace, economic, and certain key legal issues.

Exhibit 4: Comparison of Fee Arrangements

40% Contingent Fee vs. 2x ROIC to Litigation Funder ($ millions)

	Recovery	$20	25	30	35	40	45	50	55	60
Litigation Costs										
$2	Contingent fee	$8	10	12	14	16	18	20	22	24
	Litigation funding	$6	6	6	6	6	6	6	6	6
$3	Contingent fee	$8	10	12	14	16	18	20	22	24
	Litigation funding	$9	9	9	9	9	9	9	9	9
$4	Contingent fee	$8	10	12	14	16	18	20	22	24
	Litigation funding	$12	12	12	12	12	12	12	12	12
$5	Contingent fee	$8	10	12	14	16	18	20	22	24
	Litigation funding	$15	15	15	15	15	15	15	15	15
$6	Contingent fee	$8	10	12	14	16	18	20	22	24
	Litigation funding	$18	18	18	18	18	18	18	18	18
$7	Contingent fee	$8	10	12	14	16	18	20	22	24
	Litigation funding	$21	21	21	21	21	21	21	21	21
$8	Contingent fee	$8	10	12	14	16	18	20	22	24
	Litigation funding	$24	24	24	24	24	24	24	24	24

Headwinds to the growth of litigation funding in the U.S. come from the U.S. Chamber of Commerce, common law doctrines, and various bar associations. Plus, well capitalized U.S. law firms are now competing with U.S. litigation finance providers for high-value contingency fee arrangements. From a standpoint of widespread market adoption, generally the last of these is the biggest headwind.

On the regulatory front, the U.S. Chamber of Commerce has been attempting to limit the use of litigation finance, which it argues increases the overall volume of litigation and presents ethical issues. The Chamber has lobbied for rules that would require parties to disclose the use of funding contracts in litigation. No one with a financial stake in the outcome of litigation, who might potentially have a conflict of interest or who might influence settlement decisions, should be able to remain anonymous, the Chamber argues. "Even when the funder's efforts to control a case are not explicit, the existence of litigation funding naturally elevates the interest of the funder above that of the party," the Chamber said. "This is especially true considering that a lawyer contracting directly with a funding company may have contractual duties to it that are separate from — and, perhaps, inconsistent with — the lawyer's professional duties to his or her client."[10] More recently, the Chamber has characterized the litigation finance industry as putting investors ahead of victims.

Limitations on litigation finance also have included the common law doctrines of maintenance, champerty and barratry. Maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome; and barratry is a continuing practice of maintenance or champerty. There is a high degree of variation among those states that continue to enforce restrictions on maintenance and champerty as to what constitutes a violation.

Litigation finance continues to be unregulated at the Federal level, and the Uniform Law Commission (whose

[10] *Legal Funders, US Chamber Weigh in on NYC Bar Study*, LAW360 (June 4, 2109), https://www.law360.com/articles/1165924/legal-funders-us-chamber-weigh-in-on-nyc-bar-study.

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proposals are often adopted by U.S. states) recently dropped a regulatory initiative. Currently only about 11 states regulate litigation funding.

In 2018 the Professional Ethics Committee of the New York City Bar Association published a non-binding advisory opinion stating that certain non-recourse agreements between law firms and funders violate Rule 5.4(a)'s prohibition on fee-sharing.[11] The Association established a Working Group on Litigation Financing which recently put forth two proposals modifying Rule 5.4(a), to afford lawyers the opportunity to access litigation funding without being in violation of the rules of ethics.[12]

RECENT DEVELOPMENTS FOR BANKRUPTCY CASES

Especially over the last five years, the U.S. litigation financing market has evolved to include bankruptcy cases. Litigation financing has been used more and more frequently by Chapter 7 and 11 trustees and receivers. While the mechanisms used by the trustees may vary, generally funding arrangements have been approved by the courts.

In *In re Ashford Hotels*, 226 B.R. 797 (Bankr. S.D.N.Y. 1998) *appeal dismissed* 235 B.R. 734 (S.D.N.Y. 1999), the court approved a funding agreement between the Chapter 7 Trustee and a creditor of the Debtor's estate. The court was presented with two potential funding agreements. One with a creditor of the estate who would pay $25,000 for administrative expenses to the estate and share any potential recovery in related litigation. The other agreement was put forth by two creditors of the estate who were also adverse parties in related litigation. The second agreement offered $50,000 but would require the Trustee to dismiss an action against the creditors/adverse parties and have judgment entered against the estate. The motions to approve the funding agreements were brought pursuant to Bankruptcy Code §364 for "administrative expenses,"[13] but the court opted to approve the $25,000 funding agreement pursuant to Bankruptcy Rule 9019[14] finding that the agreement really constituted a compromise or settlement. When comparing the two proposed funding agreements, the court held that the Trustee's acceptance of the $25,000 agreement was "reasonable" because it afforded the estate an opportunity to share in any further recoveries. The second funding agreement was not reasonable and would limit any potential creditor recover to .0042%. The court held that the $25,000 funding agreement was the only "hope of providing a benefit to the creditors" and therefore approved the funding agreement.

The court in *Realan Investment Partners, LLLP v. Meininger*, 505 B.R. 571 (M.D. Fla. 2014), approved two separate agreements pursuant to Bankruptcy Rule 9019. The first was between the Chapter 7 Trustee and various parties involved in litigation against the former CEO/owner and his family members for alleged fraudulent transfers and constituted a more traditional, albeit complicated and nuanced, settlement. The second agreement was between the Trustee and bond companies involved in an adversarial proceeding against joint venture partners of the Debtors that had allegedly received fraudulent transfers and was, in essence, a funding agreement. The funding agreement provided that the bond parties were to fund all of the professional fees and costs of litigation up to $750,000 and in exchange, would receive a portion of any award or settlement pursuant to a distribution schedule. The Trustee would retain ultimate control of the litigation except that if the bond parties were not pleased with an offer of settlement, they could pay the Trustee the proposed settlement amount and continue the litigation on their own. The District Court held that the Bankruptcy Court did not err in approving the funding agreement, finding that the agreement provided an "obvious benefit to the Debtors' estates," that it did not constitute a sale of estates' rights under 11 U.S.C. § 363(b)(1), and that 11 U.S.C. § 364(c) was inapplicable.

Similarly, in *Dean v. Seidel*, Civil Action No. 3:20-CV-01834-X, WL 1541550 (N.D. Tex. Apr. 20, 2021), the District Court affirmed the Bankruptcy Court's approval of a funding agreement that entitled the funder, a creditor, to reimbursement of its expenses, 30% of all recoveries and a pro rata share as one of the Debtor's creditors. Even though the agreement put the lender in a position of a super-creditor, and the District Court had concerns that the agreement was incompatible with numerous provisions of the Bankruptcy Code, the District Court concluded that the Bankruptcy Court did not make a mistake and affirmed the approval of the funding agreement.

One exception to Bankruptcy Court approval is *In re Designline Corp.*, 565 B.R. 341 (Bankr. W.D.N.C. 2017). The liquidating trustee in *Designline* sought court approval to obtain litigation financing in order to sue the Debtor's former officers and directors. The trustee proposed "selling" a "portion of the proceeds" from three adversary proceedings pursuant to "Prepaid

[11] The Association of the Bar of the City of New York Committee on Professional Ethics, *Formal Opinion 2018-05: Litigation Funders' Contingent Interest in Legal Fees*, July 30, 2018.

[12] New York City Bar, *Report to the President by the New York City Bar Association Working Group on Litigation Finance,* Feb. 2020.

[13] 11 U.S.C. § 364(b) states that a court "may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a)… as an administrative expense."

[14] Bankruptcy Rule 9019(a) states that "[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement." Fed. R. Bankr. P. 9019(a).

Forward Purchase Agreements" and "Retention Agreements." The court denied approval, finding that the proposed agreements were champertous and violated North Carolina law.[15]

Since "litigation financing is in its infancy" and "[e]vidence suggests that even the ancient Greeks and Romans resented the notion that an outsider could fund an action on behalf of a litigant," the court ruled that because the proposed agreements gave the funder too much control over the litigation they were champertous. The funder was under no written obligation to continue to advance costs but would still be entitled to repayment of its litigation advances. In addition, pursuant to the Agreements, the trustee was required to request funding on a quarterly basis and to consult with the funder regarding any substitution of counsel. As the court opined, the funder had the power to "kill the litigation."

However, more recently, in *Valley National Bank v. Warren*, the Liquidating Trustee entered into a litigation funding agreement with A/Z Partners wherein A/Z Partners agreed to finance the closing costs for the sale of the Debtors' assets and to pay for an adversary proceeding against Valley National Bank which was being sued for the alleged fraudulent transfer of $3,000,000 of the Debtors' money. The Bankruptcy Court approved the litigation funding agreement pursuant to Bankruptcy Code §§ 364(c)(1), (c)(2) and (d)(2), noting that the Liquidating Trustee "retained [the] ultimate decision-making authority" despite Valley National's argument that the "financial interests of A/Z Partners could impair the good faith effort of the Liquidating Trustee to negotiate with Valley National." The Court found that the agreement 'best served the Debtors, creditors, and other parties and that it [was] "neither champertous nor usurious."' *Valley Nat'l Bank v. Warren*, Case No. 8:20-CV-1777-KKM, 2021 WL 1597960 *4 (M.D. Fla. Apr. 23, 2021)(11th Cir. appeal filed May 24, 2021). Valley National appealed and the District Court dismissed the appeal for lack of standing. The Court held that Valley National was "not a person aggrieved in [the] case because it does not have a property interest or similar right directly at stake in the bankruptcy court's order approving the funding agreement", nor did it have an interest protected by the Bankruptcy Code. *Id.* at *16 and 18. The Court opined that, "[a]n interest like the one Valley National asserts might belong to creditors or the estate, but not to a party seeking to avoid financial obligation to the estate." *Id.* at *19.

CONCLUSION

Considerations identified in this article are relevant to the availability, structure, and pricing of litigation finance. Many times, the eventual proceeds of post-confirmation recovery actions are a main component of recovery for unsecured creditors. Although sensitive to budgets and efficiency of services, the perspective of a litigation funder is that the cost of legal and expert services for pursuing these recoveries is more in the nature of an *investment* rather than a *cost*. The litigation funder may be an important stakeholder to assist in maximizing creditor recovery, especially when, upon deeper analysis of the merits of recovery claims and litigation budgets, the cash set aside in restructuring negotiations for pursuit of post-confirmation recovery actions is suboptimal.

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[15] North Carolina law defines champerty as "a form of maintenance whereby a stranger makes a 'bargain with a plaintiff or defendant to divide the land or other matter sued for between them if they prevail at law, whereupon the champertor is to carry on the party's suit at his own expense." *Wright v. Commercial Union Ins. Co.*, 63 N.C.App. 465, 305 S.E.2d 190, 192 (1983)(quoting *Smith v. Hartsell*, 150 N.C. 71, 63 S.E. 172, 174 (1908). Maintenance is defined as "an officious intermeddling in a suit, which in no way belongs to one, by maintaining or assisting either party with money or otherwise to prosecute or defend it." *Id.* (quoting *Smith*, 63 S.E. at 174).

A PRIMER ON SECTION 382 BUILT-IN GAINS AND LOSSES

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How proposed Treasury regulations could result in a large de facto tax increase for corporations with loss carryforwards.

Congress enacted "new" section 382 as part of the Tax Reform Act of 1986 to provide a comprehensive system to prevent trafficking in NOLs.[1,2] This code section was designed to make a buyer economically indifferent to acquiring a corporation with or without NOLs. Under highly complex rules, this goal was partially accomplished by limiting the utilization of NOLs to the value of the corporation immediately before a section 382 ownership change[3] (and subject to certain adjustments), multiplied by a prescribed long-term tax-exempt rate[4] (the "base limitation").[5] An acquirer would thus be able to use net operating losses at approximately the same rate as if they had invested the same amount of money in long-term tax-exempt bonds. The calculation of this component of the section 382 limitation has been relatively straightforward and uncontroversial.

SECTION 382(H) – BUILT-IN GAINS AND LOSSES

In addition to the base limitation, section 382 also takes into account certain built-in items to increase or effectively decrease the annual base limitation. Unlike the base limitation, the calculation of built-in items has been the subject of considerable debate and uncertainty.

As an example of a built-in item, assume immediately before the ownership change the loss corporation had an asset with a fair market value of $100 and an adjusted basis of $0. If the corporation had sold the asset before the ownership change, the NOL on the ownership change would have been $100 lower (*i.e.*, the pre-existing NOLs would be available to offset that income without limitation). To recognize how this pre-change sale could impact NOLs subject to limitation, Congress enacted section 382(h). Generally, section 382(h) provides that if the asset is sold within a prescribed 5-year recognition period after an ownership change, the section 382 limitation may be increased by an amount up to the $100 recognized built-in gain.[6] Similarly, if the loss corporation had an asset with an adjusted basis of $100 but a FMV of $0, the sale of such asset during the 5-year recognition may be treated as a recognized built-in loss – and then treated as a pre-change loss subject to the section 382 limitation.[7]

In order to assess the impact section 382(h) has on the loss company's section 382 limitation on an ownership change date, the loss corporation compares the FMV of all its assets to the adjusted tax basis in such assets existing immediately before the ownership change. If the FMV of the assets exceeds the aggregate adjusted basis in the assets in excess of the threshold amount (discussed below), then the loss corporation is in a net unrealized built-in gain ("NUBIG") position.[8]

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1 *See* H.R. Rep. No. 426, 99th Cong., 1st Sess. 256 (1985). See also, S. Rep. No. 313, 99th Cong., 2nd Sess. 232 (1986).

2 Sections 382 and 383 currently limit utilization of net operating losses, capital losses, R&D and GBC credits, section 163(j) and other carryforwards. References to NOLs encompass all attributes subject to limitation. A "loss corporation" is a C corporation with any such attribute carryforward(s) which makes it subject to the section 382 rules.

3 In very general terms, under Byzantine and labyrinthine rules, a section 382 ownership change occurs when there is more than a 50% change in ownership of a loss corporation (by value) over a prescribed "testing period." Section 382(g)(1). A "testing period" is a three-year rolling period, and is shorter when there has been a prior ownership change in the prior three years, or the company has not been a loss corporation for three years. Section 382(i).

4 Section 382(b). Every month, the Treasury issues a Revenue Ruling that includes the "applicable federal rate" for section 382 ownership changes occurring during that month.

5 Note in the case of multiple ownership changes, NOLs are available based on the most restrictive limitation to which the NOLs are subject. In a simple example, $100 of NOLs generated as of 12.31.X1 are subject to limitation of $10 / year. $120 of NOLs generated as of 12.31.X2 are subject to limitation of $8 / year. In that case, all NOLs are essentially subject to the $8 / year limitation (the most restrictive limitation). If the $120 of NOLs subject to the 12.31.X2 limitation alternatively have a limitation of $12 / year, then the $100 of NOLs subject to the 12.31.X1 limitation would be subject to the prior $10 / year limitation, and the $20 of NOLs generated between 12.31.X1 and 12.31.X2 would have a $12 / year limitation. However, as of 12.31.X3, while $20 of NOLs subject to the 12.31.X1 limitation would have freed up, they are still subject to the $12 / year 12.31.X2 limitation. As such, only $12 of NOLs would be available as of 12.31.X3 (the most restrictive limitation).

6 Section 382(h)(2)(A).

7 Section 382(h)(2)(B).

8 Section 382(h)(3)(A).

Alternatively, if the aggregate adjusted basis in the assets exceeds the FMV by the threshold amount, then the loss corporation is in a net unrealized built-in loss ("NUBIL") position.[9] If the difference is lower than the lesser of $10 million or 15% of the FMV of the assets before the ownership change (the "threshold amount"), then the corporation is in neither a NUBIG or NUBIL.[10]

For a company in a NUBIG position immediately before the ownership change, only recognized built-in gains ("RBIGs") during the section 382(h)(7)(A) 5-year recognition period would increase the section 382 limitation.[11] Similarly, for a loss corporation in a NUBIL position immediately before the ownership change, only recognized built-in losses ("RBILs") during the 5-year recognition period would be treated as pre-change losses.[12]

The definition of RBIG and RBIL also includes certain items of "built-in" income or loss. Any item of income which is properly taken into account during the recognition period but which is attributable to periods before the change date shall be treated as RBIG for the taxable year in which it is properly taken into account ("built-in income").[13] Contrarily, any amount which is allowable as a deduction during the recognition period (determined without regard to any carryover) but which is attributable to periods before the change date shall be treated as RBIL for the taxable year for which it is allowable as a deduction ("built-in loss").[14]

One item of built-in income that could give rise to RBIG is cancellation of indebtedness income ("COD" income). As described later, the inclusion of COD income in NUBIG/NUBIL calculations, as well as treating COD income as RBIG, has been a complex issue for which guidance from the government has changed over time.

The calculation of RBIGs (or RBILs), in general, has presented many practical issues for both taxpayers and the government. Section 382(h)(2) places the burden on a loss corporation in a NUBIG to establish that *any gain* recognized is RBIG (and conversely, that *any loss* recognized by a loss corporation in a NUBIL is not RBIL).

Assume a taxpayer sells an asset three years after an ownership change for a $100 gain (and the taxpayer was in a NUBIG position on the ownership change date). To determine if any or all of the $100 gain was RBIG, the taxpayer would have been required to determine the adjusted tax basis and FMV for that asset on the ownership change date. Then assume the taxpayer has tens of thousands of assets and perhaps has experienced multiple section 382 ownership changes. The practical challenge of this requirement to appraise and trace strained the ability of taxpayers to calculate and for the IRS to audit.

NOTICE 2003-65

In order to address the logistical issues described above, the Treasury issued Notice 2003-65, 2003-2 C.B. 747[15] (the "Notice"), which provides two safe harbors to calculate the recognition of built-in gains and losses, the 1374 approach and the 338 approach.

The 1374 Approach

The 1374 approach is generally favorable to taxpayers in a NUBIL position. The Notice provides:

> In cases other than sales and exchanges, the 1374 approach generally relies on the accrual method of accounting to identify income or deduction items as RBIG or RBIL, respectively. Under this approach, items of income or deduction properly included in income or allowed as a deduction during the recognition period are considered "attributable to periods before the change date" under sections 382(h)(6)(A) and (B) and, thus, are treated as RBIG or RBIL, respectively, if an accrual method taxpayer would have included the item in income or been allowed a deduction for the item before the change date.[16]

As such, only those items that an accrual method taxpayer would have been allowed as a deduction before the ownership change would be treated as RBIL under the 1374 approach. Moreover, the 1374 approach only allows for a benefit for taxpayers in a NUBIG position if the asset is actually disposed during the recognition period.

With respect to COD income, the Notice provides:

> The 1374 approach generally treats as RBIG or RBIL any income or deduction item properly taken into account during the first 12 months of the recognition period as discharge of indebtedness income ("COD income") that is included in gross income pursuant to section 61(a)(12) or as a bad debt deduction under section 166 if the item arises from a debt owed by or to the loss corporation at the beginning of the recognition period. However, the reduction of tax basis does not affect the loss corporation's NUBIG or NUBIL under section 382(h)(3).
>
> <u>Example 8</u>. LossCo has a NUBIG of $300,000. On the change date, LossCo has an asset with

9 *Id.*

10 "Under section 382(h)(3)(B), if a loss corporation's NUBIG or NUBIL does not exceed a threshold amount (the lesser of $10,000,000 or 15% of the fair market value of its assets immediately before the ownership change), the loss corporation's NUBIG or NUBIL is zero. Thus, a loss corporation cannot have both a NUBIG and a NUBIL, but it can have neither." Notice 2003-65, 2003-2 C.B. 747, page 4.

11 Section 382(h)(1)(A).

12 Section 382(h)(1)(B).

13 Section 382(h)(6)(A).

14 Section 382(h)(6)(B).

15 https://www.irs.gov/pub/irs-drop/n-18-30.pdf.

16 Notice 2003-65, page 8.

Continued from p.23

a fair market value of $200,000 and a basis of $150,000. The asset is subject to a debt with an adjusted issue price of $98,000. During Year 1 of the recognition period, LossCo satisfies the debt by paying the lender $95,000. On its tax return for Year 1, LossCo includes in gross income $3,000 of COD income. That amount is RBIG in Year 1. In Year 2, LossCo sells the asset for $200,000. The $50,000 of gain recognized on the sale of the asset is RBIG in Year 2.

Example 9. The facts are the same as in Example 8, except that $3,000 of the debt is discharged in a Title 11 case. LossCo excludes the $3,000 of COD income under section 108(a) and reduces the tax basis of the asset from $150,000 to $147,000 under sections 108(b)(5) and 1017(a). The $3,000 of COD income that is excluded from income is not treated as RBIG. However, because the basis reduction is treated as having occurred immediately before the recognition period for purposes of section 382(h)(2), the $53,000 of gain recognized on the sale of the asset is RBIG. [17]

The 338 Approach

The 338 approach is generally favorable to taxpayers in a NUBIG position. The Notice provides:

> The 338 approach identifies items of RBIG and RBIL generally by comparing the loss corporation's actual items of income, gain, deduction, and loss with those that would have resulted if a section 338 election had been made with respect to a hypothetical purchase of all of the outstanding stock of the loss corporation on the change date (the "hypothetical purchase"). As a result, unlike under the 1374 approach, under the 338 approach, built-in gain assets may be treated as generating RBIG even if they are not disposed of at a gain during the recognition period, and deductions for liabilities, in particular contingent liabilities, that exist on the change date may be treated as RBIL.

This ability to generate RBIGs from "wasting assets" (*i.e.*, for assets that were not actually disposed during the 5-year recognition period) is the most taxpayer beneficial feature of the 338 approach.[18]

Below (Exhibit 1) and on the following pages (Exhibits 2 and 3) is a simplified case study to illustrate the 338 approach for a hypothetical ownership change occurring on January 1, 2020. In this example, no assets are actual sold and there are no items of built-in income. Instead, all of the RBIGs are generated from the hypothetical step-up of wasting assets (in this case, fixed assets and goodwill).

Note in Exhibit 3 (on page 26) that the base limitation is often quite low compared to the RBIG. As the RBIG is recognized in the first five years after the ownership change, the NPV of NOL utilization in the first five years can thus be relatively high, while the NPV of NOL utilization after the first five years is generally low.

Companies in the life science and technology arena are often in a NUBIG position, as most of their value is derived from self-created intangibles with little or no tax basis. Per the section 382(h)(7)(A) prescribed 5-year recognition period, the RBIG for such corporations with few fixed assets would generally reflect the amortization of intangibles and goodwill for only 5 years of the 15-year life for such hypothetical section 197 assets. To the extent that a company has shorter-lived assets, such

[17] Notice 2003-65, pages 10, 11.

[18] "Prior to the issuance of Notice 2003-65, the Treasury Department and the IRS issued Notice 87-79 (1987-2 C.B. 387) and Notice 90-29 (1990-1 C.B. 336), which provided much more limited guidance regarding the determination of built-in gains and losses." Preamble to proposed regulation sections 1.382-2 and 1.382-7.

Exhibit 1: 338 Approach – A Simplified Case Study

Base Limitation

Net equity value of the Company	10,000,000	
Applicable federal rate for the month of the ownership change - Rev. Rul. 2020-1	1.59%	(see Rev. Rul. below)
Estimated annual §382 limitation without recognized built-in gains	159,000	*(A)*

Adjusted Grossed Up Basis

Total equity value of Company	10,000,000	
Plus assumed liabilities	2,000,000	
Adjusted Grossed Up Basis	12,000,000	*(B)*

REV. RUL. 2020-1 TABLE 3

Rates Under Section 382 for January 2020

Adjusted federal long-term rate for the current month	1.57%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	1.59%

Exhibit 2: 338 Approach Case Study, Cont. – Hypothetical Section 338 Step-Up[19, 20]

	FMV	Adjusted Tax Basis	Hypothetical Purchase Price Allocation	Gross Up	
Class I:					
Cash and equivalent	1,000,000	1,000,000	1,000,000	-	
Total Class I:	1,000,000	1,000,000	1,000,000	-	
Class II:					
Marketable securities	100,000	100,000	100,000	-	
Total Class II:	100,000	100,000	100,000	-	
Class III:					
Accounts Receivable	950,000	950,000	950,000	-	
Total Class III:	950,000	950,000	950,000	-	
Class IV:					
Inventory	1,200,000	1,200,000	1,200,000	-	
Total Class IV:	1,200,000	1,200,000	1,200,000	-	
Class V:					
Depreciable Fixed Assets	5,000,000	950,000	5,000,000	4,050,000	*(C)*
Total Class V:	5,000,000	950,000	5,000,000	4,050,000	
Class VI:					
Intangibles	-	-	-	-	
Total Class VI:	-	-	-	-	
Class VII:					
Goodwill	-	-	3,750,000	3,750,000	
Total Class VII:	-	-	3,750,000	3,750,000	
Total Assets	8,250,000	4,200,000	12,000,000 *(B)*	7,800,000	

as traditional manufacturing companies with substantial fixed assets, the RBIG may be comparatively higher as more of the NUBIG might be recognized in the 5-year recognition period.

Under the 338 approach, built-in income items are also favorably treated. For example, COD income that is included in gross income under section 61(a)(12) and that is attributable to any pre-change debt of the loss corporation is RBIG in an amount not exceeding the excess, if any, of the adjusted issue price of the discharged debt over the fair market value of the debt on the change date.[21]

PROPOSED REGULATIONS

On September 9, 2019, the Treasury Department ("Treasury") and the Internal Revenue Service ("IRS") released proposed regulations[22] (the "proposed regulations") that withdraw and obsolete Notice 2003-65. These proposed regulations would completely eliminate the section 338 approach.[23] In the example above, NOL utilization would be limited to the $159,000 annual base limitation, plus any *actual* sales of built-in gain assets and built-in income items. The $5.3 million of RBIG calculated under the 338 approach, in that example, would thus be eliminated by the proposed regulations, rendering the NPV of pre-change losses close to nil.

The proposed regulations would require the use of the 1374 approach, but with taxpayer unfavorable modifications. The proposed regulations "would significantly modify the 1374 approach set forth in Notice 2003-65 to include as RBIL the amount of any deductible contingent liabilities paid or accrued during the recognition period, to the extent of the estimated value of those liabilities on the change date."[24] Under the 1374 approach in Notice 2003-65, contingent liabilities are included in the calculation of NUBIG/NUBIL but are not treated as RBILs.

As such, for taxpayers in a NUBIL position, the proposed regulations retain the 1374 approach, modified to increase RBILs. For taxpayers in a NUBIG position, the proposed regulations eliminate all RBIGs except for

[19] In this example, the hypothetical fixed asset reflects an alternative deprecation system ("ADS") straight-line life of 5 years. Under the 338 approach, the fixed assets would be depreciated under whatever method (and lives) the taxpayer is actually using (which could be MACRS or ADS). Notice 2018-30, 2018–17 I.R.B. 508, provides that bonus depreciation may *not* be taken in computing the section 338 approach.

[20] Note that intangibles and goodwill are amortized over a 15-year straight-line period. As the section 382(h)(7)(A) RBIG recognition period is only 5 years, only 5/15ths (or 1/3rd) of the hypothetical intangible/goodwill asset creates RBIG, as discussed above.

[21] Notice 2003-65, page 17.

[22] REG-125710-18. https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-18152.pdf.

[23] " . . . . the Treasury Department and the IRS have concluded that the 338 approach lacks sufficient grounding in the statutory text of section 382(h). Further, the Treasury Department and the IRS have determined that the mechanics underlying the 338 approach (i) are inherently more complex than the accrual-based 1374 approach, (ii) can result in overstatements of RBIG and RBIL, and (iii) as a result of the TCJA, would require substantial modifications to eliminate increased uncertainty and ensure appropriate results." Preamble to proposed regulation sections 1.382-2 and 1.382-7. These assertions have been heavily criticized by commentators.

[24] Preamble to proposed regulation sections 1.382-2 and 1.382-7.

Continued from p.25

Exhibit 3: 338 Approach Case Study, Cont. – Recognized Built-in Gains

Recognized Built-in Gains							
Year>	1	2	3	4	5	Total	
Depreciation	810,000	810,000	810,000	810,000	810,000	4,050,000	*(C)*
Amortization	250,000	250,000	250,000	250,000	250,000	1,250,000	
	1,060,000	1,060,000	1,060,000	1,060,000	1,060,000	5,300,000	*(D)*

NOL Utilization [25]				
Year	Base *(B)*	RBIG *(D)*	Total	Cumulative
1	159,000	1,060,000	1,219,000	1,219,000
2	159,000	1,060,000	1,219,000	2,438,000
3	159,000	1,060,000	1,219,000	3,657,000
4	159,000	1,060,000	1,219,000	4,876,000
5	159,000	1,060,000	1,219,000	6,095,000
6	159,000	0	159,000	6,254,000
7	159,000	0	159,000	6,413,000
8	159,000	0	159,000	6,572,000
9	159,000	0	159,000	6,731,000
10	159,000	0	159,000	6,890,000
	1,590,000	5,300,000	6,890,000	

actual sales of built-in gains and built-in income. The regulations are thus unfavorable to taxpayers in both NUBIG and NUBIL positions.

With respect to COD income, the proposed regulations generally would not allow COD income to be included in the calculation of NUBIG/NUBIL, but would provide certain exceptions. One major exception is that all includable COD income of the loss corporation that is recognized on recourse debt during the 12-month period following the change date would be eligible for inclusion in the NUBIG/NUBIL computation.[26]

In addition, the proposed regulations provide limitations relating to the extent excluded COD income is treated as RBIG. The proposed regulations also provide that COD income recognized during the post-change period generally would not be treated as RBIG. However, these proposed regulations would provide taxpayers with the option to treat certain COD income recognized during the first 12 months of the recognition period as RBIG (and consequently to make corresponding adjustments to the taxpayer's NUBIG/NUBIL computation as described above).[27]

Transition Guidance

On January 10, 2020, the Treasury Department and IRS proposed transition guidance ("transitional guidance") relating to the proposed regulations issued on September 9, 2019.[28] This transitional guidance provides that the final regulations (if and when actually issued) would generally be applicable thirty days after publication of the final regulations in the Federal Register (the "applicability date"). Exceptions to this rule include ownership changes that occur pursuant to an order of a court (or pursuant to a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case provided that the taxpayer was a debtor in a case before such court on or before the applicability date.

The proposed transition guidance also provide that taxpayers may retroactively apply the provision in proposed regulation section 1.382-7(d)(5) that certain carryforwards of business interest expense disallowed under section 163(j) would not be treated as recognized built-in losses under section 382(h)(6)(B) if such amounts were allowable as deductions during the five-year recognition period.

SUMMARY

The first component of the section 382 limitation, the "base" limitation, has been relatively uncontroversial.

In contrast, the second component of the section 382 limitation, the calculation of RBIG or RBIL, has been the subject of considerable uncertainty and debate. As noted above, the RBIG component to the section 382 limitation may dwarf the base limitation, especially given low prevailing interest rates.

While section 382(m) instructs the Treasury to prescribe regulations to carry out the purposes of sections 382 and 383, no final regulation have been issued for section 382(h), relating to the calculation of NUBIG/NUBIL and RBIG/RBIL.

Notice 2003-65 offered both taxpayers and the government much needed clarity and guidance regarding the application of section 382(h).

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25 This schedule reflects 10 years of NOL utilization. However, if there were NOLs in excess of $6.89M, the rollout schedule would continue until the pre-change NOLs expired or were utilized (at the rate of $159K / year under the base limitation). Note that NOLs generated after the 2017 tax year have indefinite lives. In general, NOLs generated before the 2018 tax year will expire 20 tax years after they are generated.

26 *Id.*

27 *Id.*

28 https://s3.amazonaws.com/public-inspection.federalregister.gov/2020-00469.pdf.

The proposed regulations have been heavily criticized and would impose a de facto large tax increase, in particular, on modern life science and technology corporations who would generally not generate RBIGs through the disposition of built-in gain assets.[29]

Moreover, for distressed companies, including those exiting bankruptcy pursuant to section 382(l)(6),[30] the limitations on the treatment of COD income as NUBIG/RBIG would similarly reduce the value of their loss carryforwards following such COD transactions.

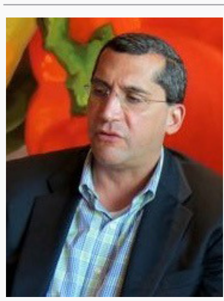
As the proposed regulations were issued over two years ago, it is difficult to predict in what form, if any, they may be adopted in temporary or final form. "The preamble to the transitional guidance implies that Treasury and the IRS understand the controversial nature of their proposal and could suggest a more balanced set of rules is under development. Because the built-in gain rules of section 382 are both complicated and changing, taxpayers should consult a tax adviser when considering transactions that may implicate these rules."[31]

29 Nick Gruidl and Amy Kasden, "Proposed Rules on Section 382 Akin to a 'Tax Hike' for Many Companies – Life Science and Technology Would Be Amongst Hardest Hit," *Tax Alert*, September 10, 2019, https://rsmus.com/what-we-do/services/tax/credits-and-incentives/operations-incentives/proposed-rules-on-section-382-akin-to-a-tax-hike-for-many-compan.html.

30 Section 382 provides two bankruptcy exceptions. Under section 382(l)(5), if certain conditions are met, there is no section 382 ownership change upon emergence from a title 11 or similar case, but certain interest deductions paid to creditors who become shareholders are eliminated from the post-emergence NOL. Under section 382(l)(6), an ownership change occurs, but the limitation is based on the value of the corporation after taking into account any surrender or cancellation of creditors' claims in a title 11 or similar case.

31 Nick Gruidl and Amy Kasden, "Proposed Rules Provide Transition Guidance for Section 382 Regulations – Proposed Built-In Gain Regulations Now Provided with Transition Rules," *Tax Alert*, January 13, 2020, https://rsmus.com/what-we-do/services/tax/federal-tax/tax-mergers-and-acquisitions/proposed-rules-provide-transition-guidance-for-section-382-regul.html.

ABOUT THE AUTHOR



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A SEPTEMBER TO REMEMBER: DOES EVERGRANDE FEEL LIKE LEHMAN?

DOMINIQUE MIELLE

As Evergrande missed its bond coupon on September 25 and edged ever so closely to the precipice of default, the media was chockfull of contrasts and analogies with the Lehman Brothers crisis of 2008. It occurred to me, and this is where my math wizardry served me so well in twenty years of hedge fund investing, that Lehman filed almost exactly thirteen years ago. Thirteen years! I could not help but wonder: do traders today have the foggiest idea what the Lehman reference is truly about?

Let me enlighten you, young reader, at the risk of aging myself but with the reward of perhaps picking you up as a Twitter follower. Because I was there in 2008, sweating it as a portfolio manager, and lived to tell the tale in my book, *Damsel in Distressed*,[1] as follows.

We found ourselves way out on a limb in underestimating and underpricing risk, and happily going about our business until such time as it could no longer be ignored. I remember the exact day that happened for me. It was Sunday, September 14, 2008. The Canyon senior managers had been invited to a beautiful party for the daughter of one of the partners. The event was held on a vast beachfront property in Malibu owned by Larry Ellison of Oracle, who has since turned it into a high-end commercial development anchored by a Nobu restaurant (let me abuse of my author power here to complain that I am never able to secure a reservation). It was a picture-perfect day and they had set up, as one does, multiple dance floors and bars, entertainers, dancers, white leather furniture, ice sculptures, and a splendid buffet. Hundreds of dressed-up guests with their spouses and children were determined to have a jolly time. Except the news never stops. Financial stories roll in before and after market hours, including Sundays. No matter the day or time, a market of something is open somewhere—Asia, Europe, currency exchange, futures. Before the end of the party, an ominous headline hit the screens of our Blackberries: Lehman Brothers to file a disorderly bankruptcy Monday morning. A bankruptcy is generally a well-planned process that a company can—no, is *expected to* —survive by optimizing its assets and reducing its debt load under the protection of the court. A "disorderly" bankruptcy is rare and extreme; it is financial chaos. George Soros later described it in rigorous medical terms. "Allowing Lehman to fail," he said, caused "a cardiac arrest of the financial system." I wondered if the party planners had arranged for defibrillators. I marveled at the ice sculpture melting away and disintegrating in the hot afternoon sun. It was exactly what the market would do on Monday. Lehman was the liquidity provider for many funds and countless companies, a critical piece of the Wall Street maze in which all the players were hopelessly intertwined. We, like every hedge fund, used Lehman as a counterparty, or a trading partner. We had not been only sitting on pending trades where we had sold them stocks, bonds and loans, but also ongoing contracts, credit and interest rate swaps, warehousing lines, you name it. So, when Lehman's stock started falling, from $65 per share at the beginning of 2008 to $12 in July, and rumors of a potential insolvency could be validated by an even cursory analysis of the cash balance, it became clear that left to its own fate, Lehman would unravel. We didn't need to wait and find out if a white knight would come to the rescue, all hands were on deck. A colleague redirected our business throughout July and August, diligently unwinding the strings that connected us to Lehman, so that when they filed, we had virtually no exposure. But he pointed out that given the speed at which one investment bank after another could melt toward bankruptcy— first Bear Stearns, then Lehman, then Morgan Stanley, Merrill Lynch, and Goldman Sachs—he would run out of possible counterparties before Christmas. Still, at the beginning of September, with Lehman's stock still hanging around $10 per share, market participants firmly expected the government to step in and arrange for a hasty merger between Lehman and a healthier financial institution, with a tidy fulfillment of its obligations to follow. I recalled Long-Term Capital in 1998, the hedge fund that was forced into a sale by the Fed to avoid a frenzied unravelling of billions of intertwined borrowings and lending around the globe. This time was different. Simply put, government officials

[1] Dominique Mielle, *Damsel in Distressed: My Life in the Golden Age of Hedge Funds,* Post Hill Press (September 7, 2021), distributed by Simon & Schuster, https://www.simonandschuster.com/books/Damsel-in-Distressed/Dominique-Mielle/9781642939729.

and Wall Street bankers ran out of time—or goodwill. The simple fact that Lehman could fail—was allowed to fail—meant that *any* bank could fail. There was no safe haven anymore in investment banks or commercial banks. Panic spread throughout the financial market, even among institutions and investments with no interconnection with Lehman at all. The cornerstone of our financial system is that banks lend liberally and cheaply to each other and to financial players all over the world. When the ability to move capital suddenly and entirely dried up, a liquidity crisis of such scale and depth ensued that it ground the economy to a complete halt. No more money flowing through the veins of the planet's financial system—an economic heart attack.

It seems to me that the Chinese government has both the will and the time to prevent financial chaos. The will, because real estate and tangential industries represent as much as 30% of the country GDP. The time, not only because of the Garcia Marquez quality of the Evergrande chronicle but also because of the wide-reaching authority of the government. Already, it appears that the Chinese housing regulator has taken control of the company's bank accounts and is directing its proceeds.

So, the question is how much of a liquidity squeeze will cessation of payment by Evergrande cause among its creditors? Naturally, many US and European banks have rushed to reassure investors that, in their shop, Evergrande never was. Grand, that is. But would anyone expect players with a large exposure to come forward publicly? The size and intermingling of that pool is key and will not come to light until and unless it must. Because for financial players, a large default can become a game of Jenga. Thirteen years ago, once the Lehman piece was taken away, the whole thing came crashing down.

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Dominique Mielle

Ms. Mielle spent twenty years at Canyon Capital, a $25 billion multi-strategy hedge fund where she was a partner and senior portfolio manager. She primarily focused on stressed and distressed investments as well as corporate securitizations. She also led Canyon's collateralized loan obligations business. In 2017, she was named one of the "Top 50 Women in Hedge Funds" by The Hedge Fund Journal and E&Y. Ms. Mielle served as a leading creditors' committee member for Puerto Rico and as a restructuring committee member for U.S. airlines in the wake of the September 11 attacks. She was a director and the audit committee chair for PG&E during its fifteen-month bankruptcy process and emergence. She is a graduate of Stanford University Graduate School and HEC Paris, and currently serves on four corporate boards.

AVOIDING THE PATH TO CLOSURE

GLENN MCLAURIN and JENNIFER RAMEY
Huron

Even before the COVID-19 pandemic, many higher education institutions were confronting structural and operating challenges. While universities and colleges with strong market presences and diversified revenue streams fared well through the 2010s, smaller tuition-dependent institutions experienced growing threats to enrollment, financial performance, and long-term viability. The emergence of COVID-19 exacerbated these conditions, creating volatility and uncertainty in enrollment, curtailing auxiliary revenues, and threatening state funding and philanthropic giving.

Higher education is facing a sea of change, with rapidly changing models for delivering instruction, challenges to justify tuition prices, and a growing gap between the wealthiest elite institutions and everyone else. Vulnerable institutions may find that, with their futures less certain, more critical introspection is needed to determine whether they are on a path to closure or if a proactive approach to identifying a merger or consolidation partner could provide strategic advantages to ensure long-term sustainability.

RECENT CLOSURES, MERGERS, AND DECLARATIONS OF EXIGENCY

Thought leaders and rating agencies have been predicting a wave of college closures for nearly a decade, and while such drastic events have not yet come to pass, each year a growing number of institutions have announced pending closures or mergers or declared financial exigency. The COVID-19 pandemic was not the sole driver of such events in 2020, but it accelerated an increasing trend.

Between January 2020 and March 2021, at least 19 institutions announced plans to close or merge or declared financial exigency (Exhibit 1). Other institutions, however, wavered publicly on how to address their paths forward, including the San Francisco Art Institute and Notre Dame de Namur University, which both announced plans to suspend admissions of future cohorts before reversing their decisions. Similarly, the chancellor of the Vermont State Colleges System proposed, but subsequently withdrew, a proposal to close and consolidate several campuses. Enrollment declines, shifting demographics, and expenses outpacing revenue growth were commonly cited as reasons for these actions.

Exhibit 1: Institutions Announcing Closures, Mergers or Financial Exigency, January 2020-March 2021

State	School	Condition	Announced
Tennessee	Watkins College of Art	Merger	January 2020
Oregon	Concordia University-Portland	Closure	February 2020
Illinois	MacMurray College	Closure	March 2020
Washington	Central Washington University	Exigency	March 2020
Missouri	Missouri Western State University	Exigency	March 2020
Ohio	Urbana University	Closure	April 2020
Nebraska	Nebraska Christian College	Closure	April 2020
Wisconsin	Holy Family College	Closure	May 2020
Massachusetts	Pine Manor College	Merger	May 2020
Missouri	Lincoln University	Exigency	May 2020
Connecticut	University of Bridgeport	Merger	June 2020
Delaware	Wesley College	Merger	July 2020
Vermont	Marlboro College	Merger	July 2020
Tennessee	Martin Methodist College	Merger	September 2020
Oregon	Pacific Northwest College of Art	Merger	September 2020
Washington	Cornish College of the Arts	Exigency	October 2020
Washington	Pacific Lutheran University	Exigency	December 2020
New York	Concordia College New York	Closure	January 2021
Massachusetts	Becker College	Closure	March 2021

These institutions, however, are far from the only ones facing revenue and enrollment challenges. In fall 2020, institutions faced sharper declines in first-time enrollment than in years past: public four-year institutions experienced declines of 8.1%, and enrollment fell more than 10% at private four-year nonprofits (Exhibit 2, page 32).[1]

While the anticipated reopening of campuses in fall 2021 may alleviate some pain, long-term enrollment concerns still abound: Free Application for Federal Student Aid (FAFSA) completion rates among high school seniors have fallen for the second year in a row. As of April 30, 2021, 5.8% fewer FAFSAs had been submitted by high school seniors than in the prior year. [2]

With so many institutions facing financial concerns and negative enrollment trends, perhaps the question to ask is not "Why are these 19 colleges declaring closure or exigency or halting new enrollments?" but instead "Why have so few colleges made this declaration?"

The nonprofit nature of colleges and universities and widely varying interests of trustees and principal stakeholders can lead to institutions enduring years of operating losses, despite experiencing mounting liabilities, declining operating income and falling enrollment. The decision to close or seek a merger partner can be politically fraught and ignite significant backlash, leading many institutions to avoid addressing their financial sustainability challenges head-on.

Closure announcements may come as a surprise to the broader campus community, but the reality is that by the time an announcement is made, these institutions have been on the path to closure for a long time.

BREAKING A CYCLE OF INEFFECTIVE EFFORTS

For institutions whose financial conditions have been further hurt by COVID-19, the goal for long-term survival should be avoiding the path to closure — or rerouting, if they are already on such a path.

The path to closure is defined by revenue shortfalls that exacerbate operating losses, leading to reductions in services and diminished capacity to recruit and retain students.

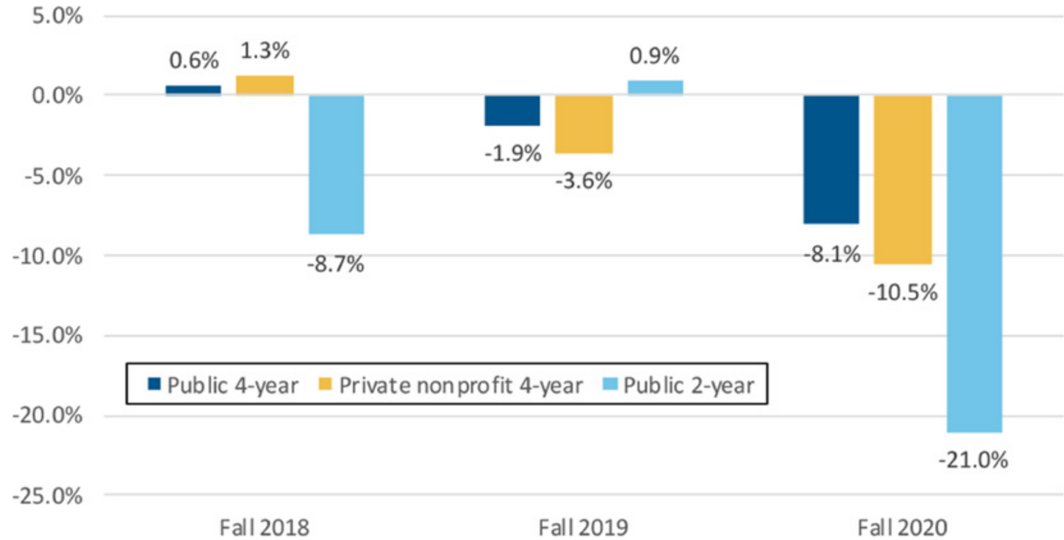
Various strategies can offset enrollment declines. Common measures over the past decade have included tuition rate increases paired with more aggressive tuition discounting, new academic program offerings, and recruiting international students.

[1] "Current Term Enrollment Estimates Fall 2020." National Student Clearinghouse Research Center, 2020. https://nscresearchcenter.org/wp-content/uploads/CTEE_Report_Fall_2020.pdf.

[2] DeBaun, Bill. "#FormYourFuture FAFSA Tracker." Tableau Public, May 14, 2021. https://public.tableau.com/profile/bill.debaun.national.college.access.network#!/vizhome/FormYourFutureFAFSATracker/ComparebyCycle.

Continued from p.31

Exhibit 2: Declines in First-Time Enrollment over Two Years, Fall 2018-Fall 2020[3]



As returns on these strategies diminish, however, declining revenue eventually leads to reductions in administrative support and leadership turnover, which ultimately undermines the institution's ability to invest in its core missions of instruction, research, and service.

Over time, even the most aggressive efforts may not be able to counter demographic and market positioning challenges. Institutions seeking to break this cycle (see Exhibit 3) may have to look beyond traditional strategies and consider alternatives like mergers or consolidations. Avoiding — or rerouting from — this path to closure in a strategic and effective manner requires a critical self-assessment.

IDENTIFYING THE WARNING SIGNS: A SELF-ASSESSMENT

For institutions that may be on the path to closure, leaders' actions are driven far more by their sense of institutional efficiency, stability and preparedness than by specific financial ratios. The following self-assessment can help leaders determine if they are, in fact, on a path to closure and, if so, provide guidance to shore up operations or explore new opportunities:

1. **Are we efficient?**

Efficiency looks different for each institution. Leadership can define these measures in terms of improved outputs rather than reduced inputs.

How do we, as an institution, define efficiency?

- Are there opportunities to take advantage of economies of scale?
- Have we leveraged institutional purchasing power to improve terms with vendors or explored consortium-based purchasing agreements?
- Do we understand where administrative and business process bottlenecks exist, as well as the root cause of these challenges?
- Have we searched for duplicative administrative services or identified self-service opportunities?

What data are needed to give leadership more time to execute our strategy?

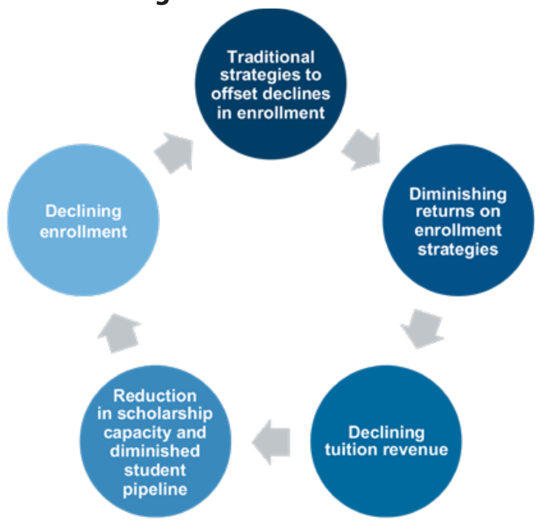
- Can we track the enrollments, revenues and costs associated with each academic program? Are we prepared to subsidize select programs as part of our strategic mission?
- Do we have a data-driven understanding of our institutional space that will help us develop an integrated operating and capital planning budget, invest more strategically or address deferred maintenance?
- Do we understand the true costs of our research enterprise, and could we more effectively manage and reinvest our facilities and administrative (F&A) cost recovery?

KEY TAKEAWAYS

- ***With rapid changes in higher education, it is critical for colleges and universities to assess if they are on the path to closure.***
- ***A proactive approach, like identifying a merger or consolidation partner, can be a strategy to ensure an institution's legacy is sustained.***
- ***Institutions can take a self-assessment to determine if they are ready for further uncertainty, asking key questions about their efficiency, stability, and preparedness.***

[3] "Current Term Enrollment Estimates Fall 2020."

Exhibit 3: Declining Enrollment and the Path to Closure



2. Are we stable?

Institutional stability reflects both financial and nonfinancial measures and requires assessing both short-term and long-term enterprise risks.

- What is the institution's liquidity profile? How long can unrestricted resources, specifically cash and short-term investments, cover operating expenses?
- How dependent are we on a single revenue source, like tuition? Can we diversify our revenue streams?
- How much of our student pipeline comes from a single demographic group or geographic area or depends on the strength of a single program?

3. Are we prepared?

Whether the institution is in a position of strength or facing financial stress, leaders benefit by taking the time to evaluate how the institution may respond to worst-case scenarios — because there will undoubtedly be more unforeseen costs, instability and uncertainty in the future.

- Have we established communication channels with stakeholders to ensure that they understand the critical decisions necessary to address future financial challenges?
- Can we quickly respond to another transition from on-campus to off-campus living and instruction? Or can we support a mix of on-campus and remote learning? Should travel restrictions impact students?
- Which debt covenants must be maintained, and which debt obligations depend on specific revenue streams? Which capital plans can be paused indefinitely, and which deferred maintenance must be addressed to avoid critical failures?
- What are the first-, second-, and third-order cost-cutting strategies that could be implemented in the event of continued budget deficits? To what extent will these capture short-term savings or risk creating long-term costs or reputational damage?

The answers to these questions may very well indicate that the institution is best served by seeking a merger partner. Doing so proactively affords leadership the time to find the right strategic partner and leverage when negotiating to protect faculty and staff and ensure the preservation of the mission (see Exhibit 4). The failure to act until a liquidity crisis or untenable enrollment levels exist will increase the risk the institution will be forced to close.

Exhibit 4: Approaches to Mergers and Consolidations

Reactive	Proactive
Common Features • Facing liquidity crisis • Violation of debt covenants or risk of default • At-risk accreditation • Enrollment below sustainable levels	Common Features: • Declining or weakening enrollment • Sufficient time and resources to plan for orderly transition and communicate with stakeholders • Specific, programmatic value for merger partner
Results In: • Difficulty finding merger partner • Limited ability to negotiate to protect faculty, staff, students, program offerings and mission • Rapid closure if no partners are identified	Results In: • Ability to be selective in identifying merger partner with complementary programs and mission • Greater ability to protect faculty, staff and students • Preservation of institutional legacy

Continued from p.33

The shifting higher education landscape will continue to serve as a challenge to the long-term viability of many institutions. Proactive leadership includes a willingness to engage in difficult conversations and conduct self-assessments now to ensure that, if a merger or consolidation is necessary, leaders are able to negotiate from a position of greater strength and find strategic alliances that best serve the institution's mission.

CONCLUSIONS

To strengthen their institutions' positioning for potential merger or consolidation opportunities, leaders should:

➢ ***Think differently***.

Approach a merger or consolidation from a forward-looking position rather than seeking an acquiring institution while your institution is facing the threat of pending closure.

➢ ***Plan differently***.

Proactively assess whether your institution is efficient, stable and prepared for worst-case scenarios.

➢ ***Act differently***.

Be willing to ask the hard, data-informed questions that could lead to the conclusion that the pursuit of a consolidation will enhance fiscal sustainability and ensure the attainment of your institution's mission.

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AIRA
Distinguished Fellows Program

The new AIRA Distinguished Fellows Program was created by AIRA's Board of Directors to recognize significant contributions to the art and science of corporate restructuring.

Purpose of Distinguished Fellows Program

- To provide a senior-level status that recognizes AIRA member achievements and contributions to the field of corporate restructuring and to AIRA.
- To distinguish AIRA members who exemplify the highest level of excellence in professional practice and whose contributions have left a significant positive legacy to the profession and the organization.

Nomination Process

Elevation to the status of AIRA Distinguished Fellow is by invitation only through a nominating process which includes:

- Submission of completed forms by any AIRA member, and
- Approval by AIRA's Board of Directors.

AIRA members who meet the following criteria are eligible to be nominated. At the time of nomination, a nominee must:

- Be an AIRA member in good standing for at least 10 years, and
- Have made contributions to the art and science of corporate restructuring and to the AIRA that may be deemed outstanding by AIRA's Board of Directors.

Recognition of Fellows

Upon approval, new Distinguished Fellows will be inducted at the AIRA Annual Conference or at AIRA's New York Plan of Reorganization Conference, and their designation will be included on AIRA's website.

Additional information about AIRA's Distinguished Fellows Program and nomination forms are available at www.aira.org.

CONGRESS SEEKS TO RESTRICT NONDEBTOR RELEASES IN NEW BANKRUPTCY REFORM BILL[1]

THOMAS R. CALIFANO and ANNA GUMPORT
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While some of the concerns regarding nonconsensual third-party releases may be valid, the Nondebtor Release Prohibition Act of 2021 goes too far in limiting what can, in the right circumstances, be a valuable tool in restructurings.

On July 28, 2021, certain members of Congress introduced the Nondebtor Release Prohibition Act of 2021 (S. 2497) (the NRPA), which proposes to amend the Bankruptcy Code to, among other things, restrict courts' ability to approve third-party releases of nondebtors and related injunctions under plans of reorganization or otherwise in Chapter 11 cases. Although the NRPA was introduced in response to testimony criticizing the third-party releases and injunctions proposed in the USA Gymnastics cases and Purdue Pharma cases, the NRPA's provisions are not limited to the mass tort context, and, if enacted, would have significant implications for all Chapter 11 cases. The authors submit that while some of the concerns regarding nonconsensual third-party releases may be valid, the NRPA goes too far in limiting what can, in the right circumstances, be a valuable tool in restructurings.

THIRD-PARTY RELEASES UNDER CURRENT LAW

Third-party releases, i.e., releases of nondebtor individuals and entities from claims of creditors and other third parties, and injunctions barring released third-party claims, have become increasingly prevalent in Chapter 11 cases. Releases and corresponding injunctions are key to obtaining funding and other contributions to the restructuring process from nondebtors who might be concerned about potential liability arising from their interactions or relationship with the debtors. These provisions tend to be heavily negotiated and litigated in the Chapter 11 https://www.law.com/newyorklawjournal/2021/09/17/congress-seeks-to-restrict-nondebtor-releases-in-new-bankruptcy-reform-bill/of the NRPA.

Courts distinguish between consensual and nonconsensual third-party releases. Consensual releases are generally viewed as permissible, but courts have reached varying conclusions as to whether the indication of consent must be affirmative or can be implied from inaction such as a failure to submit a ballot or "opt out" when voting on a plan. See, e.g., *In re SunEdison*, 576 B.R. 453, 458-61 (Bankr. S.D.N.Y. 2017) (discussing differing views). Federal circuits are split regarding the permissibility of nonconsensual third-party releases, but a majority of circuits permit them under certain circumstances. Compare, e.g., *Deutsche Bank AG, London Branch v. Metromedia Fiber Network (In re Metromedia Fiber Network)*, 416 F.3d 136, 141-42 (2d Cir. 2005) (discussing circuit split and siding with courts permitting third-party releases), with, e.g., *Resorts Int'l v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401-02 (9th Cir. 1995) (holding that 11 U.S.C. §524(e) precludes bankruptcy courts from discharging liabilities of nondebtors). While courts permitting nonconsensual third-party releases differ in the particular fact-specific tests they apply in determining whether such relief is justified, they all treat such releases as requiring heightened scrutiny for approval.

Both consensual and nonconsensual releases in Chapter 11 plans are typically accompanied by injunctions barring third parties from pursuing the released claims. In rarer instances, courts may issue "channeling injunctions" under which third-party claims against the debtor and select nondebtors are channeled to a settlement trust, but such relief tends to be reserved for mass tort cases. Although channeling injunctions are only expressly authorized for asbestos cases pursuant to §524(g) of the Bankruptcy Code, they have been implemented in numerous non-asbestos mass tort bankruptcy cases

[1] This article was published online at law.com, New York Law Journal, September 17, 2021, https://www.law.com/newyorklawjournal/2021/09/17/congress-seeks-to-restrict-nondebtor-releases-in-new-bankruptcy-reform-bill/. Reprinted with permission from the NYLJ © 2021 ALM Media Properties, LLC.

over the past several decades. Courts will enforce plan injunctions against third parties seeking to pursue claims against nondebtors released under Chapter 11 plans.

Regardless of any jurisdiction-specific tests they apply, courts' discretion to grant third-party releases and related injunctions in bankruptcy cases is not without limits. For example, the court must determine whether it has subject matter jurisdiction under 28 U.S.C. §1334(b), which involves an inquiry into whether the claims proposed to be released and enjoined would otherwise have an effect on the estate. See, e.g., *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 214 n.12 (3d Cir. 2000) ("Although bankruptcy subject matter jurisdiction can extend to matters between non-debtor third parties affecting the debtor or the bankruptcy case, a court cannot simply presume it has jurisdiction in a bankruptcy case to permanently enjoin third-party class actions against non-debtors." (citations omitted)). Further, releasing third parties must be afforded due process, i.e., adequate notice of the release. See, e.g., *Johns-Manville v. Chubb Indem. Ins. Co. (In re Johns-Manville)*, 600 F.3d 135, 158 (2d Cir. 2010) (holding that third party that had not received adequate notice of channeling injunction was not bound by bankruptcy court order issuing injunction).

IMPACT OF THE NRPA

The NRPA narrows the scope of consensual third-party releases and injunctions, and would generally prohibit nonconsensual third-party releases and injunctions. The NRPA's restrictions would broadly apply to court approval of "any provision, in a plan of reorganization or otherwise, for the discharge, release, termination, or modification of," or any order granting, "the discharge, release, termination, or modification of" the liability of a nondebtor or its property for any "claim or cause of action of an entity other than the debtor or the estate," as well as any injunction of such third-party claims or causes of action.

The NRPA requires that for a third-party release to be consensual as to a party, that party must "expressly consent in a signed writing," thus doing away with the ability to obtain "opt out" releases or releases of claims of non-voting creditors. Additionally, consent must be given after notice that is "clear and conspicuous" and "in language appropriate for the typical holder of such claim or cause of action," and the party must not be treated more or less favorably under a plan "by reason of" such party's consent or refusal to consent.

If a third-party release or injunction does not qualify as consensual under the NRPA's strict standard, such relief would be prohibited, subject to limited, specific exceptions. Certain of these exceptions, such as those preserving courts' ability to authorize "free and clear" sales and prevent third parties "from exercising control over or otherwise interfering with a right or interest (including a claim or cause of action) that is property of the estate," are quite narrow and would prohibit many of the third-party releases and injunctions currently common in Chapter 11 cases. Among other things, the NRPA makes no express exception for exculpation (limiting liability) of non-estate fiduciaries like lenders and plan sponsors for actions in connection with Chapter 11 cases. While the precise scope of the NRPA's ban on nonconsensual third-party releases and injunctions is subject to debate, it would potentially extend well beyond the types of individual tort claims at issue in mass tort cases like Purdue Pharma and USA Gymnastics.

OBSERVATIONS

While the NRPA may be well-intentioned, it would appear to run counter to core restructuring aims such as the ability to rehabilitate enterprises and preserve going concerns and to ensure that similarly situated creditors receive similar treatment. Although critics have claimed that third-party releases allow wrongdoers to evade liability, there is no convincing empirical evidence that the tort litigation system, with its attendant costs and delay, offers a more just and effective means of recovery than a plan process that fairly calculates potential liability and provides for an efficient distribution mechanism.

Facilitating settlements, binding holdout creditors where essential to the debtor's successful reorganization and supported by a supermajority of affected parties, and a general need for speed are all fundamental bankruptcy principles. If the NRPA is enacted, nondebtors will be more reluctant to fund Chapter 11 cases and incentivized to engage in prolonged litigation to limit their liability. The result will likely be diminished recoveries for both traditional creditors, who will not have access to funding, and tort creditors, who will be forced to compete in seeking redress from nondebtors in the tort litigation system.

Although it is possible that in some cases, forcing nondebtors that are potentially co-liable with the debtor to file for bankruptcy rather than obtaining protection through settlements under the debtor's plan

Continued from p.37

might result in greater recoveries for certain creditors, it is far from clear that this would be true in all or even a majority of cases, nor that compelling such filings would be beneficial to the debtor's and nondebtors' many other stakeholders or the broader economy. The current system may not be perfect, but for the most part, it has functioned fairly and effectively in balancing the rights of the numerous parties involved while facilitating successful restructurings and equitable distributions of assets by companies otherwise unable to resolve their liabilities.

Courts and parties-in-interest should and generally do carefully scrutinize third-party releases and injunctions to prevent overreaching. However, flexibility to fashion creative solutions is crucial in the bankruptcy context. Eliminating courts' discretion to approve nonconsensual third-party releases and injunctions and restricting their ability approve consensual third-party releases and injunctions are major changes that would disrupt the legal framework established over the last several decades for resolving liabilities in Chapter 11 cases, and could have severe negative consequences. Any such changes should only be made, if ever, after careful consideration of less-drastic alternatives and implications for all types of cases and stakeholders.

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QUANTIFYING VALUE CREATED FROM PRIVATE EQUITY ESG INITIATIVES[1]

GEORGE PUSHNER, PH.D., and P.J. VISCIO
Kroll

Environmental, social, and governance (ESG) factors have become a significant and a continued focus for investors. According to Prequin,[2] 1,600 private capital funds have been closed by ESG-committed GPs since 2015, and this has raised $1.69 trillion of capital.

The focus on ESG may or may not correlate with value for investors, however. There is a large body of literature that addresses whether a focus on ESG (or 'responsible') investing helps or hurts returns. We do not address that complex issue here, but instead we hope to provide insight on how to measure the value creation impacts from specific ESG activities at the individual company level.

A wealth of ESG metrics and data have proliferated from well-known non-governmental organizations (NGOs) and commercial data providers. Many widely utilized metrics attempt to measure value to society and are inherently non-financial, but as investors seek to determine whether ESG activities have enhanced financial returns, a number of financial measures are now included.

> ***It is apparent that both traditional and financial metrics suffer from a lack of standardization and transparency in reporting. But even more problematic, at least from our perspective, is that they do not measure or identify value creation from an investor's perspective.***

While at least two papers do address ESG and value creation, we believe these efforts are incomplete as they 1) do not measure or incorporate impacts on the risk of the firm, and 2) appear to lack integration of the various financial impacts with the costs of the ESG initiatives.

Value creation from ESG initiatives can be measured, however, and we suggest a more comprehensive framework for measuring ESG value creation that builds on the Kroll Created Value Attribution (CVA) Framework ("the Kroll CVA Framework," fka the Duff & Phelps CVA Framework).

We also note, however, that many aspects of ESG policies and initiatives are important, but inherently difficult to quantify and the Kroll CVA Framework lends itself more readily to certain aspects of ESG than others. For example, the quality of governance policies is difficult to quantify, but likely to be an important factor in evaluating an ESG program. The analysis of ESG efforts is a rapidly evolving field with many aspects, and while the Kroll CVA Framework offers a major advancement in terms of measuring value creation, the measurement of ESG impacts remains a key challenge in many areas.

This paper begins with an overview of widely utilized and financial metrics and the challenges they pose to investors. We then explore efforts to identify ESG-driven value creation more directly, and the limitations that we observe in this regard. Finally, we show how value creation attributable to ESG initiatives can be measured through the Kroll CVA Framework.

THE WORLD OF ESG METRICS

There are a large number of both ESG metrics and ESG data providers that compete for the attention of investors and other interested parties. According to the Global Initiative for Sustainability Ratings, back in 2016

[1] For other articles in the Kroll Value Attribution Whitepaper Series, see https://www.kroll.com/en/insights/publications/alternative-asset-advisory/measuring-organic-deleveraging-in-created-value-attribution-analysis; https://www.kroll.com/en/insights/publications/alternative-asset-advisory/measuring-alpha-for-private-equity; https://www.kroll.com/en/insights/publications/alternative-asset-advisory/whitepaper-series-value-preservation-age-of-covid-19.

[2] ESG Goes Mainstream in Private Capital," Prequin Ltd., August 2020, https://www.preqin.com/insights/research/factsheets/esg-goes-mainstream-in-private-capital.

Continued from p.39

there were more than 125 ESG data providers.[3] As a sample of the metrics, we can look at those provided by MSCI, where we find 56 non-financial metrics that cover areas such as climate change, natural capital, pollution and waste, human capital and corporate behavior.[4] Within these categories the metrics cover risk exposures, controversies and performance. But the metrics only provide a simple flag of negative, neutral, or positive and therefore do not assess the magnitude of any impacts.

Gaining insight from the data above is further complicated by a lack of standardization and transparency across providers. State Street observes that "the lack of standardization and transparency in ESG reporting and scoring presents major challenges for investors... it's important for asset owners and managers to understand the inherent limitations of this data, as well as the challenges of relying on any one provider."[5]

Furthermore, ESG metrics have to date delivered limited, if any, value to investors in terms of assessing financial impacts from ESG initiatives. "Because they were not designed to measure financial value, ESG metrics have proven ill-suited to helping investors discern the financial impact of companies' ESG performance."[6] While the existing data and metrics may provide some useful information in terms of flagging risks and the directions of ESG impacts, they typically do not provide financial information and are difficult to interpret and score.

MEASURING ESG VALUE CREATION

As we seek to measure ESG value creation, it is important for us to first define such. We assess and attribute created value in the realm of private equity through the lens of the change in enterprise value of the portfolio company (which in our view is the first step in assessing whether value has been created through 'building better businesses'). In the context of ESG, an initiative can increase the enterprise value of the portfolio company by increasing revenue and/or EBITDA, reducing risk, and so forth, and reduce the enterprise value through higher operating costs. Ultimately the balance sheet impacts of ESG driven capital expenditures must also be reflected, whether financed by cash, debt or equity.

In this light, we are aware of two recent papers that endeavor to bridge ESG data metrics and value creation. The first is a 2017 paper in *The Journal of Environmental Investing*.[7] Glassman et al. propose an investor-oriented conceptual framework and methodology for producing company-specific ESG value creation metrics. The framework is cash flow oriented and consists of three steps:

1. The development of an ESG strategy that identifies value creating opportunities, upside potential, and downside risks across the entirety of the company's operations and industry value change;
2. The identification of the mechanisms by which each initiative drives cash flow; and
3. Selection of operational ESG value creation metrics that can convey the impact of the ESG strategy on financial performance and health.

For example, a strategy to reduce employee turnover via ESG-focused measures may aim to reduce costs and improve margins, but such marginal improvement may be difficult to measure. And so instead the company will focus on metrics such as the comparison of ESG-engaged turnover rates with averages, and levels of workforce pride, and job satisfaction as measured by employee surveys.

While this framework is a logical approach where cash flow impacts cannot be measured directly, by relying on indirect measures it ultimately can only provide indirect indications of value creation rather than a direct measure.

The second paper is a recent article in the McKinsey Quarterly, which moves substantially closer to what we believe is the right approach. Henisz, et al.,[8] posit that ESG links to cash flow in five important ways:

1. Facilitating top-line growth
2. Reducing costs
3. Minimizing regulatory and legal interventions
4. Increasing employee productivity
5. Optimizing investment and capital expenditures

We agree that these factors capture much of the main routes for ESG initiatives to influence cash flows. However, we would propose to refine this list as follows:

a) We agree that improved governance can improve investment and capital expenditure decisions (point (5)), although this is likely to be extremely difficult to measure as we typically do not know what decisions or strategy would have been pursued in the absence of the improved governance. We would instead propose that such governance impacts can be better measured by the impact on the multiple of the firm (typically Total Enterprise Value/ EBITDA), which in turn can be broken into two key areas – future growth

[3] "The ESG Data Challenge," State Street Global Advisors, March 2019, https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/esg-data-challenge.pdf.

[4] "MSCI ESG Metrics," MSCI.COM, https://www.msci.com/esg-metrics.

[5] State Street, p 1-2.

[6] Diana Glassman, Matthew Potoski, and Patrick Callery, "Missing Metrics that Matter to Investors: How Companies Can Develop ESG Financial Value Creation Metrics," *The Journal of Environmental Investing* 8, no 1, 2017.

[7] Glassman, et al.

[8] Witold Henisz, Tim Koller, and Robin Nuttall, "Five Ways that ESG Creates Value," McKinsey Quarterly, November 2019.

Exhibit 1: Building on the Value Bridge to Measure ESG Value Creation

expectations (which we refer to as "growth profile") and impacts on risk and the cost of capital.[9] (These impacts on the multiple are explained further in the following section)

b) We would prefer to simplify the list to note that the impacts of points (3) and (4) should ultimately be observable either in revenue growth and cost or margin impacts identified as points (1) and (2) or through impacts on the multiple through growth profile and risk/ cost of capital (see (a) above).

c) The operating costs and capital expenditures of the ESG initiative must also be included.

Thus, we would recharacterize the five key ESG value creation drivers as follows:

- Revenue enhancement
- Cost savings/margin improvement
- Growth profile enhancement
- Risk reduction
- Costs of the ESG initiatives

QUANTIFYING ESG-DRIVEN VALUE CREATION THROUGH THE KROLL CVA FRAMEWORK

The traditional framework (often called the 'Value Bridge') for private equity value attribution relies on three factors: 1) Change in EBITDA, 2) Change in the Multiple (of TEV to EBITDA), and 3) Change in Net Debt. The Kroll CVA Framework first goes beyond the basic Value Bridge to separate revenue and margin impacts, and macro cost of capital impacts from expected growth. The Framework then integrates benchmarking and the isolation of add-on acquisitions, and ultimately segregates performance into four sources: industry/ sector, capital markets/Beta, deleveraging and Alpha.

The Kroll CVA Framework, in our view, represents the leading candidate for an industry standard for robust created value attribution analysis and the more meaningful measurement of Alpha for private equity investments. As such, the methodology behind the Framework has been made fully transparent and detailed in our whitepaper on the Framework.[10] It is also fully described in the Insead GPEI study entitled "Value Creation 2.0,"[11] and is highlighted in a recent video on private equity value creation by Steven Balaban of the University of Waterloo and the University of Toronto.[12]

It is a logical and straightforward step to utilize the Framework to measure value creation from ESG initiatives. The net impact on created value is simply the sum of the ESG value creation drivers discussed above.[13]

We show schematically in Exhibit 1 how this analytical Framework builds on the Value Bridge.

As described earlier, the value drivers from an ESG initiative should fall into the categories depicted above, and if this can be measured the resulting impact on value is straightforward.

As an illustrative example, let's suppose a car rental business changes its entire fleet of 100,000 vehicles from non-hybrid to hybrid. Prior to the change, the company had LTM revenue of $1 billion, EBITDA of $100 million, no debt and an estimated fair value of equity of $1 billion. They found that the change increased annual revenue (beyond industry growth) by 4% due to customer preferences for greener cars and higher rental rates, with half of the increase from higher market share and half from higher pricing. While the cars are more efficient, the reduced fuel costs went primarily to customers, but margins did increase by 200 bps due to the higher pricing they were able to command.

[9] Henisz, et al., do discuss ESG impacts on risk and reference several papers on this topic but they do not include risk in their five links to value creation.

[10] "Created Value Attribution: Assessing How Value is Created in Private Equity Investments," https://www.kroll.com/en/insights/publications/alternative-asset-advisory/assessing-how-value-is-created-in-private-equity-investments

[11] "Value Creation 2.0: A Framework for Measuring Value Creation in Private Equity Investment," INSEAD Global Private Equity Initiative, February 2016..

[12] https://www.youtube.com/watch?v=QFfsvksyVy0.

[13] This should be done on a present value basis but as a start we can simply look at the sum of the associated cash flows.

Continued from p.41

And they estimated, based on the valuation multiples for green rental businesses vs traditional rental companies, that their valuation multiple increased by 0.5x reflecting an increase in growth profile resulting from the initiative. No changes were expected or observed for the risk of the business, but the change did entail a capital cost of $2,000 per vehicle. And while car resale costs did increase, this was essentially offset by higher replacement costs for future hybrid purchases, and so the capital cost appeared to be a one-time expenditure.

So, what is the full value impact of this ESG initiative?

Using a relatively simple example, the following table illustrates the multiple components of ESG value creation. And note that if we leave out any of these components, the interpretation of the value impact of this initiative would be very different.

Revenue Enhancement	$40 million ($40 m annual revenue impact times current 1.0x revenue multiple)
Margin Improvement	$208 million (change in EBITDA of $20.8 m {based on $1,040 m revenue x 200 bps margin increase} times original EBITDA multiple of 10.0x)
Growth Profile	$62.4 million (post initiative EBITDA of $124.8 m times 0.5 x increase in EBITDA multiple)
Costs of Initiative	$-200 million (100k cars times $2,000 per car)
Total ESG Initiative Value Creation	**$110.4 million**

INTEGRATION OF ESG VALUE CREATION WITH THE KROLL CVA FRAMEWORK

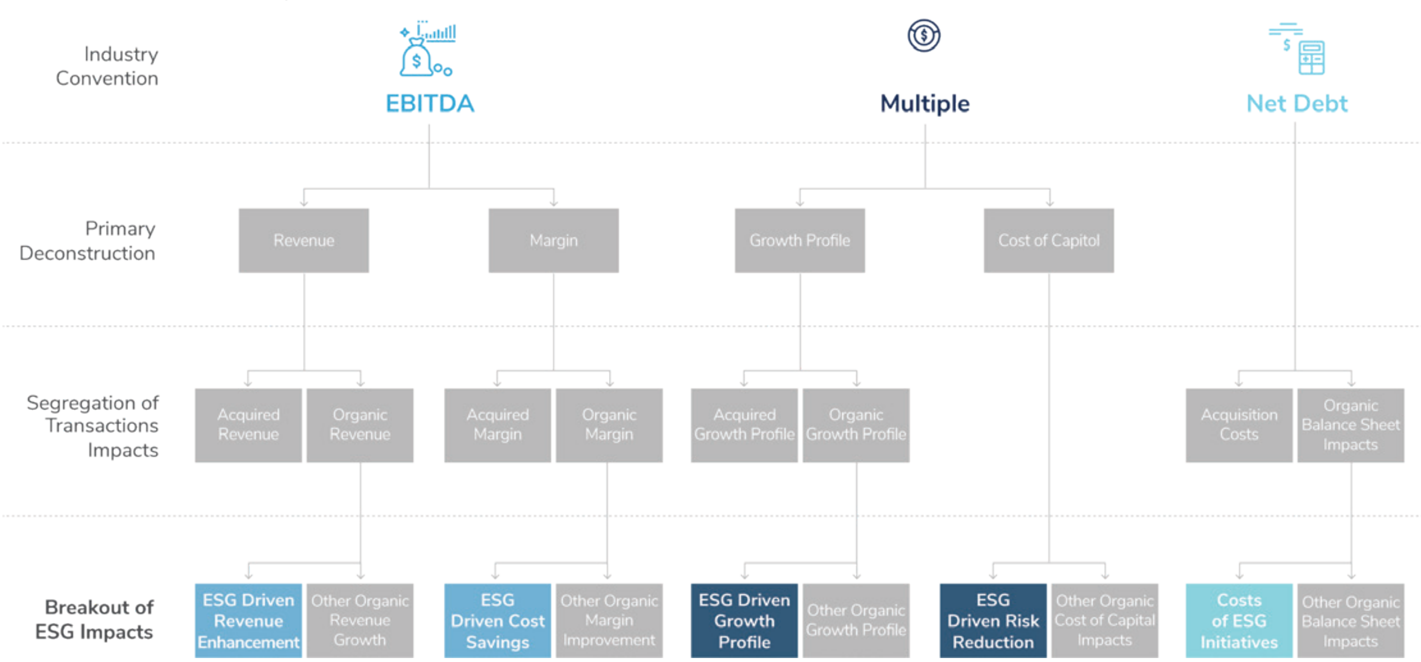
This ESG value creation analysis can then be integrated with a comprehensive CVA analysis to identify both ESG value creation and other organic value creation.

As depicted in Exhibit 2 below, the Kroll CVA Framework analysis begins with the Value Bridge and then separates revenue and margin impacts and macro cost of capital impacts from growth profile impacts (on a risk adjusted basis). The CVA Framework then adjusts for the purely transactional impacts relating to add-on acquisitions, which then isolates the organic impacts of revenue, margin, growth profile and changes in balance sheet components. And after separating the ESG value drivers identified above, the Kroll CVA Framework identifies the breakout between components of ESG value creation and other organic value creation. [14]

Thus, we can build on the Value Bridge to directly measure ESG value creation, and with the incorporation of the full CVA Framework, we can provide this identification of ESG value creation within the context of other organic value creation. Ultimately, we can identify both ESG value creation and other organic value creation or Alpha, and therefore add new meaning and detail to the assessment of GP value add.

[14] Note that we do not include benchmarking of industry/sector impacts here as we do not believe it is currently feasible to estimate industry/sector ESG value creation.

Exhibit 2: Incorporating ESG Value Creation into the Kroll CVA Framework



CONCLUSION

ESG has become a large and growing focus for investors, but it remains very difficult to measure ESG success, especially in terms of value creation. There are many ESG metrics provided by a number of well-known data providers, but these metrics suffer from both a lack of standardization as well as transparency. And from a more fundamental investor's perspective, they do not measure or identify value creation.

To truly measure ESG value creation, it is necessary to quantify the financial impacts of ESG efforts in terms of current and future revenue growth, margin improvement, risk and the cost of capital. And then these financial impacts should be integrated with the cost of the efforts.

The Kroll CVA Framework provides unique insight into value creation due to its granular analysis of value drivers, and it is easily enhanced to integrate ESG financial impacts and measure ESG value creation. Moreover, it does not rely upon forecasted financial information for ESG initiatives nor estimates of required rates of return. Additionally, it is built upon the traditional Value Bridge with which the limited partner community is familiar.

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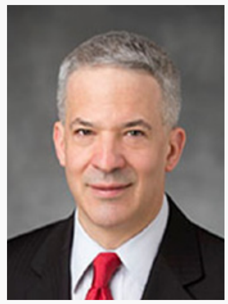

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VALUE MAXIMIZATION THROUGH THE DIP BUDGET: A CREDITOR'S PERSPECTIVE[1]

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The position of unsecured creditors in Chapter 11 cases is often not an enviable one. However, through informed use of the Bankruptcy Code and careful consideration of DIP budgets, these creditors (particularly through formal, collective action) have an array of tools at their disposal to improve their position in a case.

INTRODUCTION

Unsecured creditors are often out-of-the-money or positioned to receive a pittance of a distribution by the terms initially proposed by Chapter 11 debtors and the secured lenders who consent to the proposal. This is particularly true if an unpaid portion of secured debt looms as a deficiency claim, threatening to further dilute general unsecured creditor ("GUC") recoveries. To extract value for GUCs, advisors of creditors—or an Unsecured Creditors Committee ("UCC") on behalf of its constituency—must be creative and assertive. Specifically, this means understanding how to find or develop leverage through law and policy to apply pressure on other stakeholders to obtain a more meaningful GUC recovery.

Each bankruptcy case generally requires a multi-faceted approach to maximize value and minimize the claims pool. For example, in cases predicated on selling the organization's main asset(s), developing an independent valuation analysis, supplementing the sale process with potential bidders, and advocating for a more creditor-friendly timeline are typical efforts to increase the numerator of the recovery equation. In addition, extending the milestones of a truncated sale process may also permit the UCC to conduct a more fulsome investigation into potential causes of action, which could also lead to a creditor's elevation in the capital stack by subordinating higher priority claims.

Reducing the denominator of the recovery equation (i.e., the universe of allowed *pari passu* GUC claims), while often overlooked, is also an effective means to enhance recoveries. For example, the DIP Budget (the allowance for debtor spend during the pendency of the case, discussed in greater detail below) may contemplate payment allowances that reduce the universe of prepetition unsecured claims. Creditors should assess the proposed budget and understand which questions to ask. For example, how much is available for section 503(b)(9) claims? Are critical vendor, tax, PACA/PASA, and other administrative or priority claims contemplated? How much does the DIP Budget provide for on account of lease liabilities? Is "stub rent" contemplated in the forecast? To what extent are cure payments budgeted? These questions, among many others, should be considered—particularly when analyzing the DIP Budget—to maximize creditor recoveries.

THE UNSECURED CREDITORS COMMITTEE

Section 1102 of the Bankruptcy Code requires that the United States Trustee ("UST") appoint a committee of unsecured creditors as soon as practicable after commencement of the case. While the UCC's composition of up to nine members often favors the inclusion of large GUC claimants who are willing to serve, the UST is typically inclined to assemble the UCC with a diverse creditor body that can function as a microcosm of the overall unsecured claims pool and be best situated to further the interests of GUCs as a group. Accordingly, the purpose of the UCC is to act as a fiduciary and provide a voice to unsecured creditors to advance their collective interests on more equal footing with that of other bankruptcy participants. Section 1103 of the Bankruptcy Code empowers the UCC to consult with the debtor, investigate the debtor and its business operations, and participate in the formulation of a plan of reorganization (the "Plan"). Additionally, as a party in interest that is entitled to receive all notices concerning motions and hearings in the case, the UCC may be heard on any issue in the bankruptcy proceeding and is empowered to select and authorize the employment of attorneys, financial advisors, or other agents (collectively, "UCC professionals") to represent or perform services for the UCC.

[1] This article expands and updates material in the article with the same name and authors published in *Financial Advisors and Investment Banking* Vol 15 No 2 (September 2021): https://www.abi.org/committee-post/value-maximization-through-the-dip-budget-a-creditor%E2%80%99s-perspective.

SPECIAL LEASE CLAIM CONSIDERATIONS

A Chapter 11 debtor, under section 365 of the Bankruptcy Code, generally has three treatment options for its unexpired commercial leases and executory contracts: (1) rejection (termination of the lease, which in the case of a real property lease results in a "capped" general unsecured claim of the lessor against the debtor); (2) assumption (continuation of the lease with all its benefits and burdens after "curing" any default); or (3) assignment (transfer of the lease to a third party, after assuming the lease and curing any default).

Stub Rent: Before Rejection, Assumption, or Assignment

The debtor-tenant has 120 days from filing for bankruptcy protection to choose how to treat its commercial leases, and the Bankruptcy Court can extend the lease assumption/rejection deadline for ninety additional days without landlord consent, but only "for cause" (further extensions are generally prohibited without landlord consent). During this period, under section 365(d)(3), the debtor is required to "timely" pay all amounts due under its unexpired commercial leases, and such amounts are treated as administrative expenses. However, when a debtor fails to pay its monthly rent and files for bankruptcy after its rent payment due date, the period from the bankruptcy petition date through the end of that month's rent period is known as the "stub period," and its treatment is dependent on the jurisdiction of the bankruptcy case.

Under the "proration approach," applicable in the Southern District of New York, the debtor is required to timely pay any portion of stub rent that is attributable to post-petition portions of the stub period. *In re Stone Barn Manhattan LLC*, 398 B.R. 359, 366 (Bankr. S.D.N.Y. 2008). Other courts, including the Third Circuit (which governs the District of Delaware) have applied the "billing date" approach, which merely requires the timely payment of rent that first comes due post-petition (thus negating any requirement of 365(d)(3) for periods between the petition date and the next billing date). *In re Montgomery Ward Holding Corp.*, 268 F.3d 204 (3d Cir. 2001). The ultimate treatment of stub rent, nonetheless, is not universally clear, even in these billing date jurisdictions. For example, in the Third Circuit a landlord creditor must affirmatively seek payment of stub rent under section 503(b)(1) as an administrative expense. *In re Goody's Family Clothing Inc.*, 610 F.3d 812, 818 (3d Cir. 2010). If the debtor (or any other party in interest) objects to such claim, the landlord carries the burden of demonstrating that the stub rent is an actual and necessary expense that benefits the estate. Even if successful, however, the immediate payment requirement for leases comes from section 365(d)(3), not 503(b), and landlords in these jurisdictions may not be paid for this stub period until the lease is ultimately assumed or the Plan is confirmed.

Irrespective of jurisdiction and the associated requirements imposed by law, a DIP Budget may nevertheless afford landlord creditors beneficial treatment. To the extent that it is beneficial to the overall constituency, the UCC can advocate for the inclusion of stub rent in the DIP Budget and ensure timely payment (or, at a minimum, that it be set aside as an administrative expense).

Rejection, Assumption, and Assignment

Section 365 of the Bankruptcy Code provides that a debtor may assume (or assume and assign) an unexpired commercial lease or executory contract after curing any default and providing adequate assurance of future performance. The assumption of leases, as amended, can materially improve recoveries for GUCs. Beyond the fact that assumption entitles the landlord to full cure under the lease documents, existing lease terms can sometimes be restructured to yield mutually beneficial economic outcomes. In today's commercial real estate market, landlords are more apt to negotiate cure, term, and overall lease structure, rather than risk being left without a tenant and potentially triggering co-tenancy clauses.

Moreover, negotiating the appropriate cure and adequate assurance amounts can yield large recoveries for creditor landlords. Because the Bankruptcy Code does not define "adequate assurance," UCC professionals have an opportunity to leverage their collective bargaining power to create adequate assurance provisions that greatly improve the position of landlords within the constituency and protect their interests on a go-forward basis. Additionally, the so-called "shopping center amendments" added to the Bankruptcy Code in 2005 guarantee that adequate assurance to shopping center landlords includes the following: (1) the tenant will have a similar financial condition and operating performance as the time of lease commencement; (2) any "percentage rent" due under the lease will not decline substantially; (3) radius, location, use, or exclusivity requirements will be followed; and (4) the lease will not disrupt any tenant

Continued from p.45

mix/balance in the shopping center. These provisions provide the UCC with a strong jumping-off point in protecting the interests of these creditors.

Lease rejection, likewise, requires careful consideration. UCC professionals should conduct an independent "4-wall profitability analysis" to ensure that management has appropriately analyzed lease rejection at the store level. Lease rejection damages, even as capped under section 502(b)(6) of the Bankruptcy Code, could result in large unsecured claims. Further complicating the matter, just as stub rent is treated differently based on locale, different jurisdictions apply section 502(b)(6) differently. Some courts limit the cap only to those damages resulting directly from termination of the lease (but not collateral claims), *see, e.g., Kupfer v. Salma (In re Kupfer)*, 852 F.3d 853 (9th Cir. 2016), while other courts have imposed the cap on all damages related to the lease contract (including rent, taxes, costs, attorney fees, and other financial covenants), *cf. In re Mr. Gatti's*, 162 B.R. 1004 (Bankr. W.D. Tex. 1994). These nuanced statutory considerations impact the cost-benefit analysis of lease assumption versus rejection, and must, therefore, be accurately reflected in both the GUC pool and the proposed DIP Budget.

OTHER CLAIM CONSIDERATIONS

Beyond the world of real property leases, there is a litany of issues that stakeholders must be equipped to assess, and proper assessment thereof may be the difference between a recovery or none at all. These issues include section 503(b)(9) claims, critical vendor status, and the priority scheme under the Bankruptcy Code more generally.

Section 503(b)(9) of the Bankruptcy Code (also a child of the 2005 amendments) grants goods sellers an administrative priority claim for the value of any goods received by the debtor within twenty days of the bankruptcy filing that were sold in the ordinary course of the debtor's business. Because section 503(b)(9) claims require both notice and a hearing, creditors must timely and affirmatively assert these claims. Advisors must also analyze governing contracts regarding the receipt of any goods in this twenty-day lookback period. Whether governed by the Uniform Commercial Code or the CISG, shifts in risk of loss are seldom discussed or analyzed by UCC professionals but should be examined closely. What precisely qualifies as "receipt" in the relevant jurisdiction to give rise to a priority section 503(b)(9) claim is an independent analysis that must be conducted in respect of the goods in question and industry standards.

A DIP Budget that does not pay administrative claims on a timely basis (e.g., one that ignores legally required payments of section 503(b)(9) claims) improperly places the burden of administrative solvency on unsecured

creditors, and UCC professionals must be up to date on debtor tactics to avoid payment of certain creditor constituencies. A recent phenomenon that UCCs have encountered is the "reverse-engineered" DIP Budget—a cash flow forecast developed with the pretense of disclosing facial solvency, which upon closer examination reveals an administratively insolvent estate. To elucidate this stratagem, UCCs may investigate the DIP Budget's underpinnings by analyzing the underlying assumptions, and potentially even depose debtor representatives with respect to these suppositions.

DIP LEGALITIES THAT IMPACT RECOVERIES

Among other leverage points that can generate recoveries are those related to the provisions of the DIP credit agreement. For instance, does the DIP financing require valuable releases? Does it propose waivers of the debtor's right to marshal assets, assert an "equities of the case" exception under section 552(b), or surcharge collateral under section 506(c)? If so, are these provisions appropriate? Does the DIP Loan propose a roll-up of prepetition debt, high effective interest rates and fees, and/or improperly placed super-priority liens? Every DIP credit agreement is unique, but these agreements often propose similar conditions. An experienced UCC professional should be aware of these "trouble provisions" to ensure that any objectionable content in the credit agreement is indeed objected to and renegotiated. For example, challenging releases and/or waivers with scope limitations and threatened litigation ensuing therefrom can provide important and meaningful value to stakeholders.

POLICY CONSIDERATIONS: TAXES AND PPP LOANS

Advisors must also remain current on changes in economic policy and regulations as, on occasion, they may have a profound impact on a UCC's ability to drive recoveries (or conversely, the debtor's ability to discharge claims). This is especially true in the climate of the ongoing pandemic, where weighing government assistance and tax consequences has become increasingly important. Does the DIP Budget account for policy benefits, such as net operating losses ("NOLs") and/or Paycheck Protection Program ("PPP") Loan discharge?

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was passed by the U.S. government providing a $2 trillion economic stimulus package. Under section 172 of the CARES Act, companies are permitted to carry back NOLs from 2018, 2019, and 2020 tax years to the previous five tax years and deduct up to 100%—an increase from 80%. For example, if a company generated NOLs in 2018, it may offset taxable income from 2013 through 2017, potentially resulting in a tax refund. Companies may evaluate using this legislation to amend 2018, 2019, and 2020 tax returns to include all losses, such as those on asset sales, inventory write-downs, or transfer pricing adjustments, to name a few. In addition, certain bankruptcy accrual (non-cash) damages, such as lease rejections, may potentially qualify, which could significantly increase tax refunds, depending on the case specifics. Further, UCCs must diligently monitor PPP Loan protection and investigate whether the grant of a PPP Loan or loan forgiveness is forthcoming. PPP Loan forgiveness is not a foregone conclusion simply because a formal insolvency proceeding was commenced.

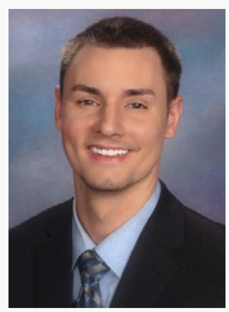
THE PRICE TO PLAY

In short, a paramount condition for a UCC and its professionals must be that the debtor prove that it has sufficient funding to confirm its Chapter 11 Plan and/or bankruptcy sale, and to conduct a post-sale wind down (if applicable). A DIP lender must understand that Chapter 11 is not a free process for its sole benefit. The DIP lender must be prepared to pay all administrative claims and finance a realistic sale process (if applicable) that paves the way to confirmation of a sale and/or Plan. If it wishes to enjoy the protections under Chapter 11 and its proposed DIP agreement, there must be a cost. A debtor must also understand that to enjoy the financing required to file for bankruptcy protection, it too must protect the value of the estate for the benefit of all creditors. These issues must be addressed early in the proceeding, if not by the debtor, then by the UCC and its professionals. To the contrary, the DIP lender may have fewer incentives to provide additional funding over the pendency of the case, or the debtor may simply not be able to confirm and effectuate the proposed Plan or sale, obviating the very purpose of Chapter 11.

ABOUT THE AUTHORS

Jorge González
Province

Mr. González is a Principal at Province, a national restructuring and financial advisory practice, where he co-manages the Miami office. He possesses considerable experience in corporate restructuring, leveraged finance, and transaction advisory services, and has led numerous creditor and debtor-side restructuring engagements across a variety of sectors. He attended the University of Chicago Booth School of Business, professionally speaks four languages, and has held prior non-profit board memberships with United Way Miami and CASA NYC.

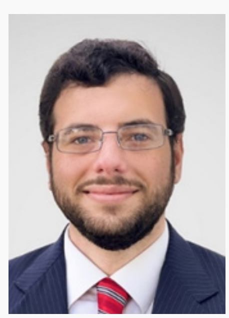


Sanjuro Kietlinski
Province

Sanjuro Kietlinski is a Principal at Province with fifteen years of experience in retail and financial advisory services. Mr. Kietlinski has extensive advisory and consulting experience with complex Chapter 11 cases and other bankruptcy-related matters and has represented chapter 11 trustees, secured creditors, and unsecured creditor committees on a national basis in cases spanning a range of industries, including retail, restaurants, consumer goods, and energy. Mr. Kietlinski holds degrees from Harvard Business School (MBA) and the University of Miami (BA).

Joseph Pack
Pack Law

Joseph Pack is the founder and managing partner of Pack Law. Mr. Pack specializes in complex financial restructuring, representing debtors, secured lenders, ad hoc groups, DIP lenders and asset buyers both in and out of court, and in chapter 11 cases in virtually every industry. Also a licensed CPA, he possesses a unique skillset having spent multiple years representing debtors and creditors, respectively, in some of the most hotly contested chapter 11 filings on record.



Jessey Krehl
Pack Law

Jessey Krehl, an associate at Pack Law, represents debtors, creditors, equity holders, sponsors, boards of directors and investors in all aspects of corporate and financial restructuring transactions in both state and Federal court across a broad range of industries.

AIRA MOURNS THE LOSS OF RETIRED BOARD MEMBER PAUL MOORE, ESQ

AIRA is saddened to report that our friend and retired board member, Paul David Moore, Esq., passed away on Thursday, October 21, 2021, at age 70.

Paul practiced law for over 40 years, for the last 22 years at the law firm Duane Morris. Paul's resume is impressive: in his academic achievements, Paul scored an impressive double eagle, graduating from Boston College in 1973 with a Bachelor of Science in Finance, *summa cum laude*, and Boston College Law School in 1976, *cum laude* and as a member of the *Boston College Law Review*. A little known fact about Paul is that he had the highest score on the July 1976 bar exam.

Always understated about his intellect, he battled fiercely for his clients using the sword of the law which he endlessly studied. A Fellow of the American College of Bankruptcy and a member of many legal professional associations and institutions, Paul also shared his expertise and skills in bankruptcy, restructuring, and turnaround by active involvement as a speaker, contributor to the *AIRA Journal*, and member of the AIRA Board of Directors. Paul served the membership of AIRA as a board member from 2006 through 2013. He was Co-chair of AIRA's 21st and 27th Annual Bankruptcy and Restructuring Conferences in Boston, and a regular contributor to AIRA's Pre-Conference Toolbox Session.

Just as many a young lawyer will say today that they are better because of Paul's not-so-subtle input on how to do a better job, so too, Paul's influence improved the skills of many financial professionals through his many contributions to AIRA and its education programs.

Paul was genuinely loved and admired by all who were fortunate to have crossed his path, and he will be greatly missed.

AIRA ANNOUNCES ITS 2021 JUDICIAL SERVICE AWARD

EDITOR'S NOTE: On November 15, 2021, the AIRA presented the Hon. Jerrold N. Poslusny (U.S. Bankruptcy Court, District of New Jersey) with its 2021 Judicial Service Award. Each year, the AIRA bestows this award at its Advanced Restructuring and Plan of Reorganization Conference held in New York City. The AIRA's Judicial Service Award recognizes distinct accomplishments and contributions to the judiciary and the bankruptcy and restructuring profession.

Jerrold N. Poslusny, Jr. was appointed to the bench for the United States Bankruptcy Court for the District of New Jersey in Camden, New Jersey in June 2015. Prior to his appointment, Judge Poslusny served as Law Clerk to the Honorable E. Stephen Derby and James F. Schneider, United States Bankruptcy Judges for the District of Maryland, then as an associate and member with the firm of Cozen O'Connor P.C. in Cherry Hill, New Jersey, and finally as shareholder of Sherman, Silverstein, Kohl, Rose & Podolsky, P.A. in Moorestown, New Jersey. Judge Poslusny concentrated his practice in bankruptcy law, workouts and commercial litigation.

Judge Poslusny received his B.S. degree from the Pennsylvania State University and his J.D. degree from the University of Maryland School of Law. He is admitted to the state bars and district courts of Delaware, Maryland, and New Jersey, and the Third and Fourth Circuit Courts of Appeal. He is a member of the National Conference of Bankruptcy Judges, American Bankruptcy Institute, Association of Insolvency and Restructuring Advisors and the Camden County Bar Association. Judge Poslusny has served as an editor, author and frequent lecturer to professional and educational organizations.

Judge Poslusny has given generously of his time to inspire and lead others in the profession. A frequent presenter, he has served on numerous conference planning committees for the leading professional organizations in the bankruptcy and restructuring field. He has introduced and promoted others to write and present, and made many contributions to mentor, guide and teach. His decisions and opinions are consequential, and they have been found to be well grounded and thorough. He displays a keen understanding of the financial and legal impact of the factual issues and the law involved in each matter.

Congratulations to Judge Poslusny on his selection to receive this distinguished award.

AIRA BOARD MEMBER ON THE MOVE

David Bart Joins Baker Tilly's Restructuring Practice

CHICAGO, IL – October 25, 2021: Baker Tilly US, LLP is pleased to announce that **David Bart** has joined its Restructuring and Complex Litigation practice as its National Director. He joins a team led by Jack Williams, Susan Seabury and Michael Deeba. David has over 30 years of experience assisting individuals, businesses and their counsel in complex matters from investigations and general consulting to commercial litigation. He has significant experience serving as a litigation consultant and testifying expert.

David brings a unique skill set that includes business and strategic analysis, forensic investigation, operational assessments, restructuring and bankruptcy, workouts, and commercial litigation. His areas of expertise include strategic planning, feasibility analysis, financial and economic analysis, investigative accounting, statistical analysis, and business valuation.

David is the current Chair and former President of AIRA, Chair of AIRA's Technical Issues and Standards Committee, and Co-Editor of the AIRA Journal. He was the primary author of AIRA's Standards for Distressed Business Valuation. He is the former Chair of the ABI Litigation Trust Task Force and primary author of Practitioner's Guide to Liquidation and Litigation Trusts. Co-author of Developing The Evidence: Using Prospective Financial Information in Bankruptcy and Other Litigation for Valuation, Damages, and Other Applications. He is active in AIRA, ABI, and TMA.

David was previously the Senior Director of the Great Lakes Region Forensics practice at RSM US LLP. He has an MBA in Finance and Accounting from the University of Chicago.

PRESS RELEASE

Stretto Receives the M&A Advisor Turnaround Product/Service of the Year Award

Sept. 29, 2021 – Stretto Corporate Restructuring Administration Services was honored as Turnaround Product/Service of the Year at The M&A Advisor 15th Annual Turnaround Awards. The in-person awards ceremony concluded The M&A Advisor 2021 Distressed Investing Summit at the New York Athletic Club, New York, NY.

This marks the second consecutive year that Stretto has received M&A Advisor's Turnaround Product/Service Award for its bankruptcy services and technology. Stretto was also recognized in the 2021 Chapter 11 Reorganization of the Year category for its role in the Neiman Marcus and Old Time Pottery cases, as well as in the Restructuring of the Year category for its role in the Vivus Inc. case.

"These award winners represent the best of the distressed investing and reorganization industry over the past year," said Roger Aguinaldo, Founder of The M&A Advisor.

"It is an honor for the entire Stretto team to be recognized once again among the turnaround industry's most highly regarded firms and professionals," remarked Jonathan Carson, co-CEO of Stretto. "As companies increasingly turned to bankruptcy as a strategic alternative to navigate the COVID-19 economic crisis, we have consistently delivered efficient and streamlined approaches to our clients' restructuring needs."

PRESS RELEASE

Cynthia Romano Named to Crain's 2021 Notable Women In Accounting and Consulting List

New York, NY – September 20, 2021 – CohnReznick LLP announced that **Cynthia Romano**, Principal and Global Director in the firm's Restructuring and Dispute Resolution practice, has been recognized by *Crain's New York Business* as one of its 2021 Notable Women in Accounting and Consulting. Each year, the publication acknowledges top women in accounting and consulting who hold senior leadership positions at public accounting firms or consultancies serving middle market and enterprise clients.

Romano has more than 25 years' experience in performance improvement, turnaround management, transaction support, and investment analysis. Since joining CohnReznick in 2019, Romano and co-practice leader and Global Director Kevin Clancy have led significant expansion of the firm's Restructuring and Dispute Resolution practice, growing it from a niche NY/NJ- based practice with nine professionals to a national practice with 29 full-time professionals, including six partners.

Romano's client work has been recognized by the restructuring industry with numerous awards including the 2021 Turnaround of the Year (Global M&A Network); 2020 Turnaround and Transaction of the Year Award (Turnaround Management Association); and 2020 Out of Court Restructuring of the Year Award (Global M&A Network). Romano is also one of *ABF Journal*'s 2021 Top Women in ABL: Strategic Advisor Recipients.

PRESS RELEASE

B. Riley Strengthens Restructuring Division with Three Senior Hires

LOS ANGELES, September 23, 2021 – B. Riley Financial (NASDAQ: RILY) ("B. Riley") today announced continued growth in its restructuring division with the addition of three new senior executives.

John Sordillo joins as a Senior Managing Director in NY with 30+ years' accounting, finance, turnaround and restructuring experience, including interim officer and chief restructuring officer in distressed situations, and as a principal investor in turnaround situations. He serves as a trusted advisor to companies, lenders, PE funds and other institutional investors across a variety of industries. He holds a BBA in Public Accounting, Pace University; JD from Brooklyn Law School.

Jeffrey Truitt joins as a Senior Managing Director leading the firm's restructuring practice in Los Angeles. He has 30+ years' experience in restructuring and turnaround serving as a trusted advisor to myriad companies, secured creditors, and ad hoc bondholder groups, among others. His designations include CIRA, CDBV, and CTP; BA (Economics) UCLA, and MBA (UCLA Anderson Graduate School of Management).

Tim Hannon joins as a Managing Director in Atlanta bringing 30+ years' experience in executive financial management and financial advisory services. He has served as CFO and Corporate Controller for companies sized $50 million to $1 billion, most recently as CFO for a $900 million fresh food CPG company. He is a CPA (NY), CIRA and CMA with a BS in Accounting, State Univ. of New York at Albany.

SUBMIT MEMBER NEWS OR PRESS RELEASES

AIRA members and their firms as well as event sponsors are invited to submit announcements for publication in AIRA Journal. See guidelines and details at www.aira.org/journal.

PRESS RELEASE

ToneyKorf Partners, LLC, Announces Key Director Changes

New York, August 17, 2021 – ToneyKorf Partners, LLC, announced the promotion of two individuals to Managing Director, and one individual to Director, effective September 1, 2021. In addition, the firm named a new Director of Operations.

Promoted to Managing Directors:

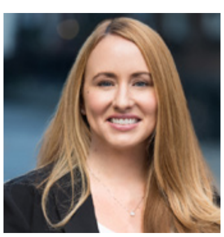
Sourav Chaudhuri – Sourav has gained deep leadership and restructuring experience from his work on ToneyKorf Partners clients, including US Family Health Plan, where he currently serves as the Chief Strategy Officer. He earned his undergraduate degree from Dartmouth College and an MBA from Columbia Business school. He is a Certified Healthcare Financial Professional.

Christopher Karambelas – Chris' experience is broad in finance and accounting, IT, hospital operations, physical plant and equipment, and data analytics. At ToneyKorf Partners, he has served as CIO and VP of operations on key client projects. A CIRA and Certified Healthcare Financial Professional, he is a graduate of Northeastern University in Business and Vermont Technical College in Computer Engineering.

Promoted to Director:

Peter Yeh – Peter has deep experience in financial planning and analysis and has significantly contributed to the firm's thought leadership, including co-development of a financial model that assisted clients with Pandemic Impact and Mitigation Strategies ("PIMS"). Peter earned his BA from the Univ. of Rochester (Financial Economics) and MBA from the Simon Business School.

Promoted to New Role – Director of Operations:



Jamy Houck – Jamy has served as the Chief of Staff to the CEO for several clients, leading change initiatives and managing the leadership of various organizations. In her new role at ToneyKorf Partners, Jamy will lead the firm's operations, including marketing, people experience, risk management, finance and accounting, and administrative operations. Jamy is a CIRA, with a bachelor's degree from the Univ. of North Carolina at Charlotte.

Alison Bauer
Foley Hoag LLP
New York, NY

Matthew Bergman
Ridge Strategic LLC
Holmes, NY

Jonathan Boffi
M3 Partners
New York, NY

Michael Branson
Paladin
Chicago, IL

Lorenzo Callerio
Alvarez & Marsal
Chicago, IL

Sean Corwen
Miami, FL

Elizabeth Dameris
Alvarez & Marsal
Dallas, TX

Douglas Deutsch
Clifford Chance
New York, NY

Kenneth Ehrler
M3 Partners
New York, NY

Brian Finkelstein
New York, NY

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New York, NY

J Gabriel Leiter
EY
Chicago, IL

Marc Miceli
SM Law PC
Oldwick, NJ

Colin Moore
RPA Advisors LLC
Chicago, IL

Jeffrey Murphy
Fulshear, TX

Philip Neuville
Paladin Management
Venice, CA

Joshua Ohman
Armanino
San Francisco, CA

Chapman Payton
FTI Consulting, Inc.
Houston, TX

Ryan Pulliam
SC&H Group
Sparks Glencoe, MD

John Sackey
FTI Consulting
Denver, CO

Shawn Smith
Riveron
Chardon, OH

Sean Sneeden
RPA Advisors LLC
Whippany, NJ

James Spencer
Sargent Consulting Group, LLC
Chicago, IL

Takaaki Tanabe
PricewaterhouseCoopers LLP
New York, NY

Vidura Ufeli
Alvarez and Marsal
Atlanta, GA

Jonathan Vukanovich
B. Riley Financial, Inc.
Tecumseh, Ontario

CLUB 10

*Organizations with 10+ professionals who are active CIRAs or have passed all three parts of the exam**

AlixPartners, LLP	**73**
FTI Consulting, Inc.	**60**
Alvarez & Marsal	**56**
Ernst & Young LLP	**33**
Huron	**20**
Berkeley Research Group, LLC	**18**
Riveron	**18**
Ankura Consulting Group, LLC	**17**
Deloitte	**17**
PwC	**16**
KPMG LLP	**15**
B. Riley Advisory Services	**12**
BDO USA, LLP	**12**
CohnReznick LLP	**11**
Office of the U.S. Trustee	**11**