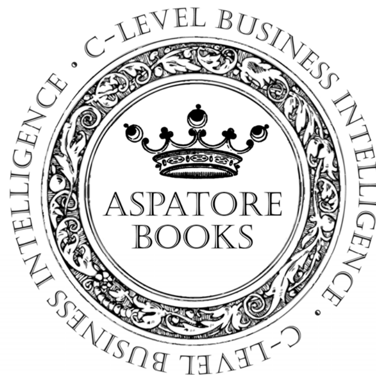
INSIDE THE MINDS

Bankruptcy and Financial Restructuring Client Strategies

Leading Lawyers on Understanding Key Business Issues, Working with Debtors and Creditors, and Formulating a Successful Strategy



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Knowing the Facts: The Key to Successful Client Strategy in Bankruptcy and Financial Restructuring

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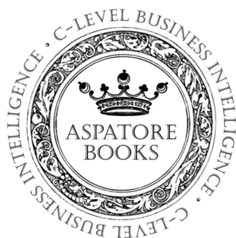


Pre-Meeting Research

Regardless of whom I am representing, I am always interested in learning about the client's business. I find it particularly helpful to have some basic knowledge about what the client does before they walk in the door. While I never profess or pretend to know everything that there is to know about a particular client or their industry, I do want to demonstrate for them that I have taken the time to educate myself. Before the first meeting with the client, I attempt to learn as much as possible about the client. In today's information age, you can access and obtain information about a company, regardless of whether they are public or private, from your desktop. Generally, I will complete an online search to locate Web sites, news articles, and any other information that may appear based on the search query. I also order a Dun & Bradstreet report, and if they are a public company, I will obtain the last two to three years of public filings. For my creditor clients this information will provide me with insight about the client's business and product. In those cases where I am representing a debtor, this information will assist me in learning about the company, its problems, and any steps that it may have already undertaken to improve its performance. Regardless of the client, taking the time to conduct pre-meeting research allows me to keep the meeting focused and to make the best use of our time.

First Meeting Tactics

First and foremost on the agenda at the first meeting, I need to determine the client's goal. What is the outcome that the client would like to obtain? In some instances, the client is unclear about its options. In those cases, I will assist the client with identifying the options and then evaluating the pros and cons of each. Once the objective is identified, it is a matter of gathering information that is tailored to reaching the objective. It is important to understand that identifying the client's objective may not necessarily happen during the initial meeting. In some instances, it may be necessary to gather more information so that the client is able to make an informed decision. This information may take the form of obtaining more financial information or involving other key members of the client's management team. Above all, knowing the client's objective is critical to ensuring that you do not stray from the path. Once the objective is clearly

defined, then you can begin to undertake the process of designing the strategy that is best suited to achieving the objective.

Formulating a Strategy

Regardless of whether you are representing a debtor, a creditor, a buyer, or a party-in-interest, it is critical that you start with the client's objective and then work backwards. Too often the lawyer's approach resembles a shotgun blast where time and effort is spent on unnecessary work. Rarely is the client pleased because even if you are ultimately successful in achieving the objective, the lawyer has wasted time and likely has amassed a large legal bill.

The judge, jurisdiction, the amount at stake, and the client's budget will all have an impact on the legal strategy and its implementation. As I often tell my clients, at the end of the day there is only one person that you need to convince—the judge. For that reason, it is important that you gain as much information as possible about the judge. Does she have a Web site? Today, most bankruptcy judges maintain Web sites that are populated with rules, information, and courtroom guidelines. Has the judge published any written opinions? A quick Lexis or Westlaw search will allow you to locate opinions authored by your judge. What is the judge's background? Did he practice bankruptcy law before taking the bench? Did he work in a large or small firm? Speak to your colleagues or peers who have practiced before the judge. Is the judge a "debtor" or "creditor" friendly judge? Talking with peers who have practiced before the judge or attending seminars at which the judge is a speaker will provide you with insight into the judge's mindset and view on particular issues. Similarly, jurisdiction is important, as the law in one circuit may be different from the law in another. It is critical that the lawyer be familiar with the law in the circuit, especially if the lawyer is practicing outside of his home jurisdiction. To the extent that you are representing a debtor and have the ability to file in more than one circuit, knowing whether the relevant circuits have opposing views on issues may dictate that you avoid filing in a particular jurisdiction. The amount at stake and the client's budget must always be taken into consideration when formulating a strategy. Even the most successful strategy can result in failure when the lawyer ignores the fact that with limited exception most clients want to limit the amount of legal fees and costs incurred.

In developing a strategy for the client, you always need to be open to alternatives and to modifying your strategy. Having a "Plan B" is very important because a rigid strategy that does not take into account changes in facts or circumstances is a losing strategy. You always need to be able to adapt your strategy to the facts presented. Rare is the case where new facts or circumstances do not arise at some point in the representation. The inability to adapt and regroup can mean the difference between winning and losing.

General Representation Approach

My general approach is as follows: 1. Define the client's goal; 2. Learn the facts of the case; 3. Map out a strategy to achieve that goal; 4. Determine the opposing party's weaknesses; 5. Use those weaknesses as a form of leverage as part of implementing the strategy; and 6. Execute on the strategy. This is a systematic approach for achieving the client's goal. It keeps the lawyer focused. When this approach is developed in tandem with the client, it provides the client with a roadmap and an understanding of the game plan. The approach is adaptable to any situation that the lawyer may encounter. There are always unanticipated issues that arise that may result in tweaking the strategy. However, as long as the client's goal remains unchanged, the strategy will likely remain unchanged.

In my opinion, the bankruptcy practice is unique. Nearly all parties in interest share the common goal of wanting to maximize value. And in nearly all cases, this comes as a result of reaching a negotiated, consensual resolution on issues that ultimately impact the outcome of the case. This does not mean that the lawyer is not a zealous advocate. Quite the opposite. Granted, there are times and occasions when a consensual resolution is not possible because the client is unwilling to settle. This represents the minority of cases. In my experience, although the client may initially state that they are unwilling to settle or compromise their position, that is rarely the case. Unless the client has an unlimited budget and a desire to simply punish the other side, very rarely does it make business sense to continue fighting and spending inordinate dollars on legal fees.

Developing Effective Strategy

In order to ensure that the most effective strategy is developed, I constantly probe and ask questions of the client that are intended to cause the client to critically examine the objective that they want to achieve. This process allows me to better understand the client's business and the nature of the problems that they are confronting. By doing so, I am able to identify the business objective and tailor a strategy that is designed to achieve that objective. As part of this process, I will typically center my questions around five main categories: 1. What is the business objective, i.e., goal?; 2. What are the facts (including harmful facts)?; 3. What are the relevant documents and who are the relevant witnesses?; 4. Are you amenable to a consensual resolution? If so, what are the realistic parameters?; and 5. What is the budget? The answers to these questions provide me with the ability to be nimble with my approach. For instance, when I am representing a creditor, the client's objective is to recover as much of the outstanding indebtedness as possible. Based on initial information, it was believed that this objective could be achieved by liquidating the debtors' assets. However, it is subsequently determined that the client's objective can be best achieved through a reorganization as a liquidation would fail to provide full recovery. The failure by the lawyer to comprehend and adapt to this change would have significant impact on the client. Similarly, knowledge of facts that are harmful to your client's position cannot be overstated. Once the lawyer is aware of a damaging fact, he will not be caught off guard. In my experience, it is always better to be the first to disclose or acknowledge damaging facts so that you can deal with them rather than being forced to respond.

Before you can begin designing a strategy that achieves the client's objective, you need to understand everything that you can about the client, their business, the underlying facts, whether there are any harmful facts that may surface during the course of the case, and whether the client has any expectations about costs. If you don't fully understand the client's business, you can't adequately map out a strategy to achieve the client's objective.

Obtaining Client Documentation

Rather than allowing the client to decide which documentation is relevant to the case, I generally have a good idea as to what I want or need to see.

This will vary from case to case. In most cases, it is important to see financial statements, public filings (if available), as well as correspondence. In this regard, I cannot overstate the importance of reviewing e-mail correspondence. In today's electronic world, e-mails are sent with little thought or regard. Oftentimes, the repercussions caused by an errant e-mail will impact the legal strategy of the case. For instance, a debtor may dispute a large claim asserted by the largest creditor in the case. The ability to reduce the dollar amount of the claim is paramount to the survival of the company. Unfortunately, unbeknownst to anyone, the debtor's chief financial officer has previously acknowledged in an e-mail the amount of the claim. While this e-mail may not ultimately prevent the amount of the claim from being reduced, it causes the company, and as a result, its lawyers to spend time and effort having to explain away why the e-mail does not constitute an admission. Cases are almost always won or lost on documentation. The information contained in the documents, whether good or bad, allows the lawyer to anticipate problems or gain leverage, and in that regard, assists the lawyer in developing the strategy.

Establishing a Positive Relationship with the Client

The key to developing a good relationship with the client is being responsive, learning about the client's business, family, and personal interests, and possessing the ability to empathize with the client's situation. The client needs to know that their matter is the most important thing on your desk. Promptly returning phone calls and e-mails lets the client know that you are attending to their needs and that you are readily available. By taking an interest in the client and their business, you can gain an understanding as to the client's values and their view of the world. In turn, there will be a free exchange of information and ideas. In my opinion, forming this relationship is essential to achieving the client's objective, as the client needs to have a trust and bond with his lawyer. If there is a breakdown in the attorney/client relationship, it is usually attributable to the lawyer's failure to promptly communicate with the client.

Determining the Client's Motivation and Goals

Speaking with the client openly and honestly offers the best insight into their motivation. This relates back to the point about developing a

relationship with the client. Once you have gained the client's trust and confidence, it is much easier to gain access to information regarding the client's motivation. This information allows you to discern whether the motivation is justified or misplaced. When the motivation is based on principle, I will have a candid discussion with the client about the hazards of proceeding on principle. With rare exception, decisions that are based on principle are often the result of clouded judgment. It is the lawyer's job to properly counsel the client regarding the pros/cons of such an approach. Ultimately, being keyed in to all the details allows the lawyer to determine just how hard to push on certain issues throughout the case.

Learning your client's ultimate goals is something that hopefully occurs early on when the legal strategy is being developed. The client's goal shapes the legal strategy. If the client's goal should change mid-case, the legal strategy oftentimes must be modified. Granted, a client's goals may change during a case based on events that occur, but you want to avoid a situation where the client has a change of heart or wants to abandon the goal for no business reason. If the client's goals are unrealistic, it is time for open and honest discussion about the pitfalls and failures that are likely to result.

Experience is a great teacher. Based on years of practice, you develop the ability to predict and forecast the likely outcome of an issue or a case based on prior experience. Using that experience, I find it very helpful to explain to the client what is likely to result in order to give the client an appreciation of what lies ahead. This strategy raises issues that the client has likely not considered. Clients appreciate and value a lawyer that understands the problem and can counsel the client on the "what ifs." It is through this process that the lawyer gains the client's trust and respect.

Developing a Theory of the Case

The theory of a bankruptcy case is developed based on the facts of the case. The theory may be utilized throughout the case or it may be utilized for purposes of a particular issue. If the debtor is attempting to rush a plan to confirmation, the theory may be that the case needs to be slowed down so that creditors have an opportunity to fully investigate what transpired pre-petition. If the debtor's officers mismanaged the debtor pre-petition and remain in control post-petition, the theory may be that the creditors, and

likewise, the court need to carefully examine the debtor's business judgment throughout the case. If the creditor is a disgruntled former employee, the theory may be that his actions are motivated by spite. If the debtor is a local company, the theory of the case may be that local jobs will be lost and the local economy will be impacted.

Once developed, I go over the theory with the client. First and foremost, I want to make sure that the client buys into the theory. The client is much closer to the situation, and typically, will have an appreciation of the facts supporting the theory. This process allows the theory to be modified based upon the client's input. At the end of the day, the client and I both need to believe in the theory. The theory is important because it supports the strategy. Strategy and theory are not the same, although they do overlap. For example, the strategy may be obtaining the appointment of a trustee. The theory is that those in control of the debtor pre-petition mismanaged the debtor, and perhaps engaged in some wrongdoing. To implement the strategy, evidence of mismanagement and wrongdoing must be compiled. Once gathered, these facts will support the theory and the strategy.

Establishing Boundaries with the Client

It is important to communicate to the client that the attorney makes decisions relating to procedure and dealing with opposing counsel. In order to gain a perceived advantage, a client will want me to wait until the last minute to serve a pleading on opposing counsel in hopes of catching counsel off guard or providing counsel with a limited opportunity to respond. Or a client may want me to take an aggressive approach with opposing counsel. Most clients are emotionally charged about the issues confronting them. I believe that my job is to bring a reasoned approached to the situation and not allow emotion to get in the way. While I am always a zealous advocate for the client, I draw the line at acts that I deem to be unprofessional. The community of bankruptcy lawyers, whether local or national, is small. If the client wants to follow a strategy that is unethical or will have negative consequences for the client or me, I have no hesitation telling the client to find another lawyer. I simply explain to the client that what is proposed is unethical or will have disastrous consequences and that I will not be involved. While it takes a long time to build a good reputation,

your reputation can be destroyed with one bad act. I refuse to compromise my reputation.

Dealing with Bad Facts

It is important to be up front and honest about any bad facts. Usually I will refer to the bad facts during my first opportunity to address the court. I want the court to hear the facts from me, not from my opposing counsel. In my experience, this approach always serves to neutralize any attempt by the opposition to call attention to the bad facts. In bringing the facts to light, you are acknowledging to the trier of fact the weaknesses of your case. I believe that judges appreciate and value the integrity of a lawyer that is up front about his case. From that point forward, my job is to convince the court that despite the bad facts, there are other mitigating circumstances in favor of the client.

The Client's Finances

The client's ability to pay my fees and costs has a tremendous impact on strategy for the case. Most disputes arising in business bankruptcy cases require both time and money. If the proposed client does not have the financial resources to carry out a winning strategy, I will have a candid discussion with the client. While discussing fees with a client is never easy, I have always found that being up front at the inception of the retention is the best practice.

Non-Legal Ramifications

I always take time to explain to the client the emotional, mental, and physical toll that the bankruptcy will take on them. These non-legal ramifications are very important. The client needs to understand that most bankruptcy cases are not a sprint, but a marathon. They need to be prepared to go the distance. If the client is not prepared, the toll of the case may ultimately result in the client wanting to abandon their effort. In this case, the strategy will need to be modified. If this occurs, the client may be forced to make a concession earlier than intended, or may be forced to reach a resolution on terms that are less than favorable.

Dealing with Ambivalence

If the client is ambivalent about the case, I explain to the client that we should wait on implementing a strategy. I do not and will not implement a strategy on behalf of a client who is having doubts about their case. In order to ensure that the course the client wants is actually followed, it is important to carefully examine the client's business decisions and to explain the pros/cons of the situation to the client. If the client's business decisions are the result of emotional (as opposed to well-reasoned) thought, I will take the time to explain to the client the flaws in his thought process.

Keys to Successful Strategy

In creating a strategy, it is most important to have an intimate knowledge of the facts and to know your client's business objective. Without an intimate knowledge of the facts, it is impossible to develop a strategy since the facts will drive the strategy. Without knowing the client's business objective, the lawyer cannot develop a strategy that is designed to achieve that objective. If you don't pay attention to the client's motivations and objectives, then you will fail to achieve the client's objective. Beyond this, you have wasted valuable time and incurred needless fees/costs. You can avoid this by gaining an intimate knowledge of the facts and knowing your client's business objective. If you find yourself mired in a difficult situation, be honest with the client. Hopefully, you will discover the error early on while there is still time to make a correction.

The two most important things in any bankruptcy case are time and money. While it is nice to have both time and money, you need at least one in order to implement a strategy for the client. With no time and no money, it is much more difficult to implement a strategy.

Common Attorney Mistakes

In developing a strategy, the most common mistake that I witness is that attorneys often fail to spend the time learning the facts of the case and/or they fail to ascertain their client's business objective. Without belaboring the point, unless you know the facts and your client's objective, you cannot tailor a winning strategy. The recipe for success is simple. You need to

know the law—that is a given. Beyond that, you need to spend the necessary time to understand the case and to learn your client's business objective. There is no substitute for hard work and dedication to your client.

Peter W. Ito is a partner with the Ito Law Group LLC. The holder of an "AV" rating, Mr. Ito has been rated as pre-eminent in his field with the highest ethical standard by Martindale-Hubbell, an authoritative resource on the legal profession.

Mr. Ito has represented creditors' committees, debtors in possession, Chapter 11 and 7 trustees, litigation trustees, secured and unsecured creditors, and buyers of distressed businesses in bankruptcy cases throughout the United States. He also has significant experience in workouts, equity and rents/profits receiverships, and counseling clients on bankruptcy considerations related to business transactions. Mr. Ito's industry experience encompasses, among other things, oil and gas, real estate (golf courses and residential home developments), telecommunications (festooned fiber-optic cable, cellular phone manufacturer and service provider, and FCC licenses), manufacturing (pre-engineered steel buildings, twist-off bottle cap tops, aircraft insulation blankets), finance (subprime mortgages, subprime credit card receivables, accounts receivable securitizations, and collateralized investments), medical (self-insured physicians group), and gaming.

Mr. Ito has significant experience representing creditors' committees in large and mid-size Chapter 11 cases across the United States. With the singular goal of maximizing value on behalf of the committee and its constituents, Mr. Ito's recent engagements as lead counsel to creditors' committees include an automobile dealership operating under a franchise agreement with General Motors, a leading maker of twist-off bottle cap tops, a pre-engineered steel fabricator with operations in the United States and Canada with secured debt in excess of $400 million, and a financial services company that offered subprime credit card origination, cardholder services, and receivable sales and securitizations; face value of portfolio in excess of $7 billion. Mr. Ito also counsels and advises clients who sit as members of creditors' committees. He represented the chair of the committee in two subprime mortgage Chapter 11 cases pending in Delaware and California.

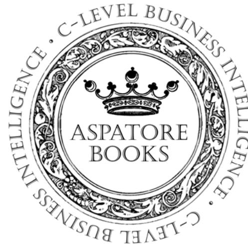
Having practiced bankruptcy law since completing a judicial clerkship with the United States Bankruptcy Court for the Southern District of California, Mr. Ito has represented debtors in possession as well as Chapter 11 and 7 trustees. Recent engagements in which Mr. Ito served as lead counsel include the owner and operator of a festooned submarine fiber-optic network

system built along the coast of California and designed to provide high capacity carrier, enterprise and governmental customers route diversity for telecommunications in California and a privately held provider of advanced text messaging and outsourced customer care and technical support. Mr. Ito currently serves as general counsel to a trustee of a litigation trust created pursuant to a plan of reorganization confirmed by the United States Bankruptcy Court for the District of Delaware.

Mr. Ito's creditors' rights practice includes representing secured and unsecured creditors on matters involving bankruptcy and the attainment of provisional remedies on behalf of secured lenders. In the bankruptcy arena, Mr. Ito has served as lead counsel to the lessor of gaming equipment involved in a dispute with the owner/operator of a "cruise to nowhere" maritime vessel in Florida and a major Korean company that sold telecommunications equipment and provided telecommunications services to a privately held provider of cellular service operating in the Midwest United States. Mr. Ito has also represented secured lenders and receivers in more than 200 equity and rents/profits receiverships in Los Angeles, Orange, Riverside, San Bernardino and San Diego counties involving multifamily housing, retail shopping centers, office buildings, restaurants, and golf courses. From 1989 through 1990, Mr. Ito served as a law clerk to the Honorable Louise DeCarl Adler, Judge of the United States Bankruptcy Court for the Southern District of California. Mr. Ito also served as a judicial intern to the Honorable Barry S. Schermer, Judge of the United States Bankruptcy Court for the Eastern District of Missouri.

Mr. Ito is a past president of the California Receivers Forum, is a past-chair of that organization's executive committee and is a former member of its board of directors. He is also the founder and first president of the San Diego Chapter of the California Receivers Forum. He is the past-chair of the San Diego County Bar Association, Commercial Law Section. Mr. Ito is a member of the National Association of Bankruptcy Trustees and the American Bankruptcy Institute.

Mr. Ito is the co-author of "Eyeing Foreign Capital, Indonesia Enacts Changes," National Law Journal*, September 14, 1998, and "Recent Developments in Chapter 7 Bankruptcy Practice,"* Bankruptcy Practice: Recent Development Programs*, CEB, 1992. Mr. Ito is also a frequent national and international speaker on insolvency matters. Most recently, he spoke at the INSOL International Conference held in the Czech Republic in October 2004, and at the Distressed Debt Summit held in New York City in February 2003 and 2004.*



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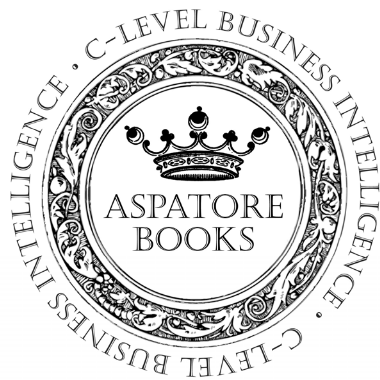
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