



# Post – Pandemic Planning: Preparing Your Business for What Might Be Next

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# Today's Speakers

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# Gary B. Rosen, CPA, CFF, CFE, CVA, CGMA

## Partner-in-Charge, VFLS Services, NY Region

Gary Rosen is the partner-in-charge in the Firm's Valuation, Forensic & Litigation Services group for the NY Region. He provides accounting, audit and consulting services, including solvency, valuation opinions and asset recovery for numerous closely-held and public corporations, real estate entities, financial services institutions, business development companies, private equity funds, government agencies and international corporations.

Mr. Rosen has approximately 40 years of financial advisory, consulting, and public accounting experience with extensive background in fraud engagements, forensic accounting, complex litigation matters, shareholder/partnership disputes and other areas of investigative accounting.

He has testified as an expert witness in numerous litigation cases in a variety of federal and state courts regarding agreed upon procedures reports, fraud, lost profits, valuations, white collar crime, solvency, commercial and residential real estate, product liability, estate matters, shareholder and partner disputes and matrimonial matters. Where he is able to communicate complex financial information in a manner judges and juries can understand.

With extensive lecture and public speaking experience, Mr. Rosen is requested at national conferences on topics relating to internal controls, fraud and audits. He is a contributing author for one of Practitioners Publishing Company's audit guides and also served as a professor at the graduate level at Monmouth University



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# Marc J. Carmel

## Member, Business Restructuring Services Dept. Co-Chair, Litigation Finance Practice Group

Marc is a member of the firm's Business Restructuring Services Department residing in the Chicago office (with clients located throughout the United States). He has two decades of experience representing public and private companies, private equity and other investment firms, directors and executives, lenders, committees, and equityholders in a variety of distress and non-distress engagements. Marc regularly advises clients regarding strategic alternatives, including: out-of-court and in court restructurings and bankruptcies; mergers and acquisitions, refinancings, recapitalizations, and sales; and fiduciary duties and governance matters throughout the United States and internationally. Whenever necessary, he assists his clients with commercial litigation in insolvency matters. Additionally, Marc has extensive experience in the litigation finance industry.



Marc is a frequent author and speaker on restructuring topics, with a focus on fiduciary duties, acquisitions of distressed assets, and cutting edge strategies and tactics to address bankruptcy issues. Marc also writes and speaks about litigation finance. Prior to joining McDonald Hopkins, Marc led representations in restructurings and bankruptcies at two major international law firms and was the leader of a litigation finance firm's involvement in the bankruptcy and restructuring sector. Marc worked for a large national accounting firm before attending law school and is a Certified Public Accountant (inactive). Marc earned his Juris Doctor from Harvard Law School and his Masters of Accounting and Bachelor of Business Administration degrees from the University of Michigan.

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# Michael J. Kaczka

## Member, Business Restructuring Services Dept.

Michael focuses his practice on corporate restructuring, commercial bankruptcy, business counseling, and creditors' rights matters. As a member in the firm's Business Restructuring Services Department, he represents businesses as debtors or creditors in various insolvency matters including chapter 11 bankruptcy proceedings, state-related insolvency proceedings, out-of-court workouts and restructurings and other commercial matters. Michael represents purchasers of assets of distressed businesses both in and out of court. Michael also has experience representing creditors' committees and liquidating trustees in various bankruptcy matters.

Michael earned a J.D. from Case Western Reserve University School of Law in 2003. He received a B.A., cum laude, from Washington and Lee University in 2000.



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# John L. Heller, CPA, CIRA, CFF

## Director, Advisory Services

John Heller is a Director in the Firm's Advisory Services Division. He joined the Firm in 2008 from Barbee & Associates where he began his professional career in 1992. In January 2008 he joined Marcum's predecessor, Rachlin Cohen & Holtz.

In addition to general business and tax accounting, Mr. Heller specializes in forensic accounting, litigation support and management duties for bankruptcy, insolvency, and litigation clients including numerous debtors, receivers, and panel trustees.

His experience includes temporary business management of Chapter 11 properties and businesses; forensic review of books and records; identification and retrieval of concealed assets; analysis of preferential and fraudulent transfers; analysis of claims; solvency analyses; preparation of operating reports; forecasts for continued operations; liquidation analyses for Chapter 11 confirmation; preparation of Chapter 11 bankruptcy schedules and statement of financial affairs; and litigation support and testimony. Additionally, Mr. Heller provides transactional services and analyses related to mergers and acquisitions, due diligence and EB5 applications.

### PROFESSIONAL & CIVIC AFFILIATIONS

American Bankruptcy Institute (ABI)  
American Institute of Certified Public Accountants (AICPA)  
Association of Insolvency and Restructuring Advisors (AIRA)  
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# Agenda/Table of Contents

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- 01 Identifying Financial and Operational Distress
- 02 Understanding Fiduciary Duties
- 03 Considering Alternatives to Address Resulting Challenges

# Typical Fact Pattern in Post-COVID-19 Environment

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- Manufacturing company extended itself beyond core business with acquisitions pre-COVID-19, which are not performing as expected
- Company financed significant pre-COVID-19 capital expenditures
- Asset based lender unable to extend more credit against company assets
- Reserves are insufficient to address all contingencies
- With last cyclical downturn more than a decade ago, company's management team has not experienced this level of distress or macroeconomic challenges
- Certain key personnel have left or are considering leaving



# Typical Fact Pattern in Post-COVID-19 Environment

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- Company's largest customer files for Chapter 11 with pre-petition accounts receivable of \$10 million amounting to 25% of total company receivables
- Contemporaneously, Company loses appeal on \$10 million lawsuit
- Company has \$10 million in inventory and \$5 million in cash
- Company has \$5 million available on LOC
- Company has \$45 million in accounts payable and other current liabilities
- Company has numerous below-market leases
- Company is otherwise in compliance with all bank covenants other than financial covenants

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# Identifying Financial and Operational Distress

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# Identifying and Addressing Financial Distress

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- Primary goal is to maintain liquidity to continue operating the business
- Liquidity: Ability to pay debts as they come due in the short-term
  - Liquidity Ratios:
    - Current Ratio = Current Assets / Current Liabilities
    - Quick Ratio = (Current Assets – Inventories) / Current Liabilities
- Solvency: Ability to pay long-term fixed expenses
  - Solvency (or Leverage) Ratios:
    - Debt to Asset = Total Debt / Total Assets
    - Debt to Equity = Total Debt / Equity
- Cash flow forecasting
  - Key part of liquidity management program
  - Many businesses don't properly focus on cash
  - Critical to keep cash moving through business
- Communication with current lenders and primary stakeholders
- Ability to secure additional debt or raise new equity
- Waiting too long to take action will severely limit options

# Build a 13-Week Cash Flow Forecast

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- Take into account
  - Delayed A/R collections
  - Delayed return of customers
  - New sources of cash and timing through debt or capital
  - Constraints and additional costs due to quarantining, social distancing, etc.
  - Contractual obligations
  - Troubled relationships with customers, suppliers, lenders, equity
  - Areas of risk with employees, customers, and suppliers
  - Potential repositioning or divestiture of business segments outside of core business both performing and underperforming
- Prepare multiple cash flow models under a wide range of assumptions regarding the dynamic nature of the above points
- Cash flow models are maintained and rolling

# Identifying and Addressing Operational Distress

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- Determine effects of quarantining, social distancing, etc. on supply chain, customers, other aspects of business
- Review fixed obligations and overhead for redundancies
- Analyze the “Core Business”
- Options for right-sizing the business
  - Using current situation to renegotiate key contract/leases
  - Evaluate growth opportunities
  - Real property/intangible assets/intellectual property
- Vendor management – identify key vendors and establish workable payment terms
- Determine if outside advisors are necessary to supplement existing operational, financial, and legal resources

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# Understanding Fiduciary Duties

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# Fiduciary Duties

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- Directors and officers of a corporation have fiduciary responsibilities (or fiduciary duties) to the corporate entity
- Specific obligations depend on state law and the form of entity (for purposes of this presentation, we reference Delaware corporation)
- The primary fiduciary duties of directors and officers are:
  - Duty of care; and
  - Duty of loyalty
- Other duties are sometimes recognized, but they typically are incorporated into the duty of care or duty of loyalty
- Fiduciary duties require directors and officers to exercise good faith and to act for the benefit of the corporation

# Fiduciary Duties: Duty of Care

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- The duty of care is an obligation of directors and officers to act in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner the director or officer reasonably believes to be in the best interest of the corporation
- The actions and conduct of directors and officers must be informed (of all material information that is reasonably available) and (carefully) considered, and decisions must be made with “requisite care”
- Directors and officers are entitled to rely in good faith on reports prepared by officers of the corporation or outside experts and advisors



# Fiduciary Duties: Duty of Loyalty

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- The duty of loyalty is an obligation of directors and officers to act on behalf of the corporation and refrain from self-dealing, usurpation of the corporation's opportunities, and any acts that result in improper personal benefit or injury to the corporation
- Directors and officers must be both disinterested and independent

# Business Judgment Rule vs. Entire Fairness

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- Business Judgment Rule - if applicable, the rule protects directors (and maybe officers) in their decision-making process
  - Insulates directors from liability for decisions made in good faith if the director: is not interested in the subject of the decision (duty of loyalty); is informed with respect to the subject of the decision to the extent the director believes appropriate under the circumstances (duty of care); and rationally believes the decision is in the best interests of the corporation (good faith)
- Entire Fairness doctrine - If the Business Judgment Rule is not applicable, the burden shifts to directors and officers to prove that:
  - a fair process was used, including how the transaction was timed, initiated, structured, negotiated, disclosed, and approved
  - the process produced a fair price or fair result

# Fiduciary Duties: Insolvent Companies

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- Generally, the nature of fiduciary duties do not change as a company approaches insolvency or becomes insolvent
  - Directors and officers of a solvent company generally owe fiduciary duties to the company and the beneficiaries are equity holders
  - Directors and officers of an insolvent company continue to owe fiduciary duties to the company, and the beneficiaries include creditors
- Common misconception that fiduciary duties run solely to creditors of an insolvent company
  - Case law on these issues has continued to evolve away from that common misconception

# Governance Provisions Reducing Liability

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- Companies can include provisions in their formation documents (particularly in LLC agreements but also certificates of incorporation) that eliminate or limit the personal liability for directors and officers arising from breaches of certain fiduciary duties, like the duty of care, or limit who can sue
- These provisions typically do not protect directors or officers from breaches of the duty of loyalty or acts or omissions not in good faith or that involve intentional misconduct, a knowing violation of law, or transactions from which the director or officer derived an improper personal benefit

# Fiduciary Duties: Takeaways

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- Directors and officers should seek advice from experienced legal advisors and financial advisors
- Directors and officers should consider all reasonably available information and alternatives before making decisions
- Directors and officers should ask questions of management and advisors
- Directors and officers should disclose actual and potential conflicts to the Board and recuse if appropriate or appoint independent directors
- Directors and officers should deliberate and be prepared to satisfy the “entire fairness” standard for transactions, especially with insiders
- Directors and officers should maintain appropriate minutes of all meetings
- Directors and officers should communicate with constituencies

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# Considering Alternatives to Address Distress

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# Alternatives to Address Distress

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- **Out-of-Court Restructuring**
  - Negotiate restructuring with creditors and parties in interest without resorting to a formal process
  - Generally debt-for equity exchange, shared pain by key constituencies, or other modifications to the capital structure (without addressing operations)
- **Article 9 Uniform Commercial Code (UCC) Sale**
  - Secured lender initiates a process after a default where it takes personal property serving as collateral and disposes of it in accordance Uniform Commercial Code Article 9 or forecloses and takes title to assets itself
  - Forecloses junior liens but does not address unsecured claims
- **Assignment for Benefit of Creditors**
  - Company assigns all of its assets to a chosen third party assignee in accordance with state common law or statutes for assets to be liquidated with proceeds distributed to creditors
  - Assignments may or may not be court-supervised, depending on the applicable state law

# Alternatives to Address Distress

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- Receivership
  - Neutral, disinterested third party is appointed by a state or federal court to receive, preserve, protect, and monetize assets; generally requested by creditors or in context of shareholder dispute
  - Possibility of injunction to prevent creditors from disrupting process
- Chapter 11 Bankruptcy
  - Court-supervised collective process pursuant to federal Bankruptcy Code to restructure business and operations and pre-bankruptcy financial obligations
  - The goal of a chapter 11 bankruptcy is the confirmation of a chapter 11 plan, which is a type of court-approved “contract” between creditors and others that modifies and supersedes pre-bankruptcy obligations
  - Not a liquidation (that’s a chapter 7 bankruptcy), though sales of some or all assets as going concern or liquidation are allowed under certain circumstances



# Alternatives to Address Distress

	Out-of-Court	Article 9 UCC Sale/ Foreclosure	Assignment for Benefit of Creditors	Receivership	Chapter 11
Party Initiating	Company or creditors can initiate process	Secured lenders under state law and contract rights	Company in accordance with state law	Secured lenders or equity holders under state or federal law	Company - voluntary filing Creditors - involuntary filing
Party Managing Process/ Company	Company	Secured lenders	Assignee	Receiver	Management under Board, unless trustee appointed
Court	None	Possibly State court; typically none	Possibly State court	Federal or State	Federal
Procedures	No formal process	Typically out-of-court with possible judicial foreclosure; real estate is separate process	State law, possibly with court involvement (state specific)	Federal or state court with procedures determined by judge	Bankruptcy Code
Speed	Varies: no structural constraints	Depends on state law; typically faster than chapter 11	Accelerated	May be faster than chapter 11	Generally slowest
Cost	Moderate, but may maximize sale price	Less expensive	Potentially least expensive	Less expensive	Highest, but may maximize price

# Alternatives to Address Distress

	Out-of-Court	Article 9 UCC Sale/ Foreclosure	Assignment for Benefit of Creditors	Receivership	Chapter 11
Disruption to Business	Most manageable	Manageable if carefully structured	Manageable if carefully structured	Manageable if carefully structured; sale is typically liquidation	Typically manageable
Publicity	Publicity may be minimized but also less controllable	Some notice of sale required, but not required to all creditors	Publicity minimized	Fewer reporting requirements than Chapter 11	Public forum with filings in Bankruptcy Court
Oversight	None	Lenders	Creditors or judge	Judge and receiver	Bankruptcy judge, committees, United States Trustee
Ability to Bind Creditors	None	Risk of involuntary bankruptcy or post-sale litigation	High but risk of involuntary bankruptcy	Risk of involuntary bankruptcy and post-sale litigation	Maximum
End Result	Consummation of restructuring by executing contracts	Consummation of private or public sale	Consummation of private or public sale and disposition of proceeds by assignee	Consummation of private or public sale approved by court and disposition of proceeds approved by court	Chapter 11 plan or sale (with possible plan, dismissal, or chapter 7 conversion)

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# Thank You!

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