

# Heroes & Horrors: Triumphs & Tragedies Unveiled

(Navigating Credit through the Eyes of the Court)

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## ENRON: THE CORPORATE FIASCO

- Creditors, law firms, accounting firms all got burned
- Enron used smoke and mirrors to hide its fraud
- Forensic experts revealed that chicanery
- But why didn't the lawyers and accountants stop the problem before it began?

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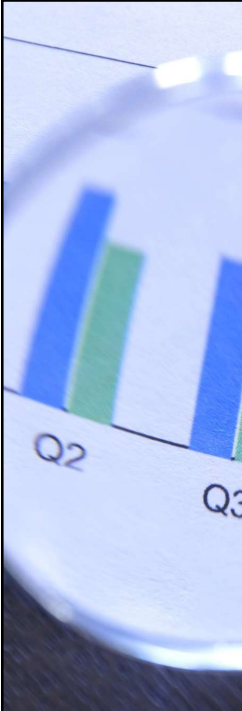
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## ENRON'S ACCOUNTING TRICKS

- **Hidden debts (example: barges) and fake SPEs**
- **Fake profits reported (that old mark-to-market perversion)**
- **Rapid rise in debt disguised**


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## NO ONE BLEW THE WHISTLE ON ENRON

- **Sherron Watkins didn't "count" as a whistleblower**
- **V&E asked to examine its own work**
- **Accounting firm destroyed documents**

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## FORENSIC WARNING SIGNALS WERE IGNORED

- **Questions about Enron’s finances were not answered (that classic earnings call)**
- **Financial statements were falsified**
- **One lesson: “ASK WHY”**

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## Sports Authority

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## CONSIGNMENT DEFINITION

Consignments

goods delivered to a merchant for sale

Merchant engaged  
in selling goods of  
others

Aggregate value of  
goods \$1000 or  
more

Goods are not  
consumer goods

Transaction does  
not create a  
security interest

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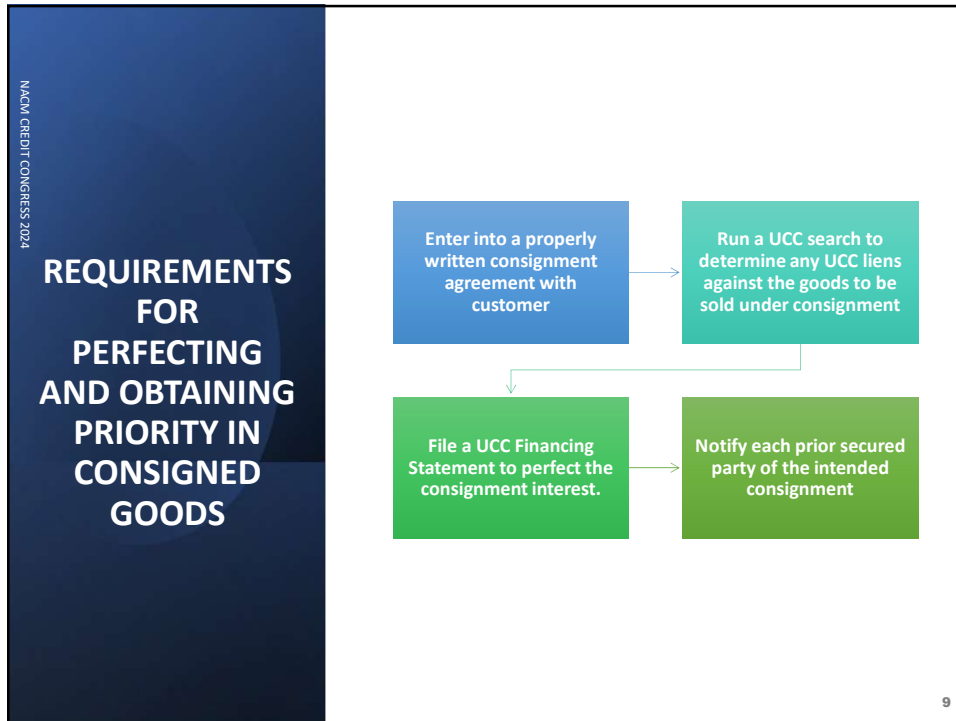
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## CONSIGNMENTS UNDER UCC ARTICLE 2

- **UCC § 2-401(a):** Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to reservation of a security interest.
- **UCC § 2-326:** If goods conforming to contract are subject to return by buyer, the transaction is a "Sale or return" if the goods are delivered primarily for resale and the goods are subject to the claims of buyer's creditors while in buyer's possession.

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## CONSIGNMENT ISSUES IN BANKRUPTCY

- **Sports Authority Case [TSA] experienced a challenge to the Validity of Consignment Agreements**
- **Most of TSA's inventory was consigned goods**
- **170 Consignment vendors**
  - **Most of the Consignments were defective**
    - **Notice not given or not properly given**
    - **UCC Financing Statements were not filed**

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**SPORTS  
AUTHORITY  
CONSIGNMENT  
ISSUES**

- **TSA sought permission to sell the consigned goods and escrow payments for the consignment vendors**
  - **Consignment Vendors objected seeking immediate payment**
  - **Secured Lender objected asserting no payments should be made at all**
- **Court granted motion to sell the consigned goods and directed payment to the Consignment Vendors in accordance with the terms of their agreements**

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**SPORTS  
AUTHORITY  
CONSIGNMENT  
ISSUES**

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graph TD; A[Secured Lender Appealed and sought a stay of all sales by TSA] --> B[U.S. District Court denied the stay]; B --> C[U.S. District Court compelled arbitration]; C --> D[Settlement was reached];
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**Secured Lender Appealed and sought a stay of all sales by TSA**

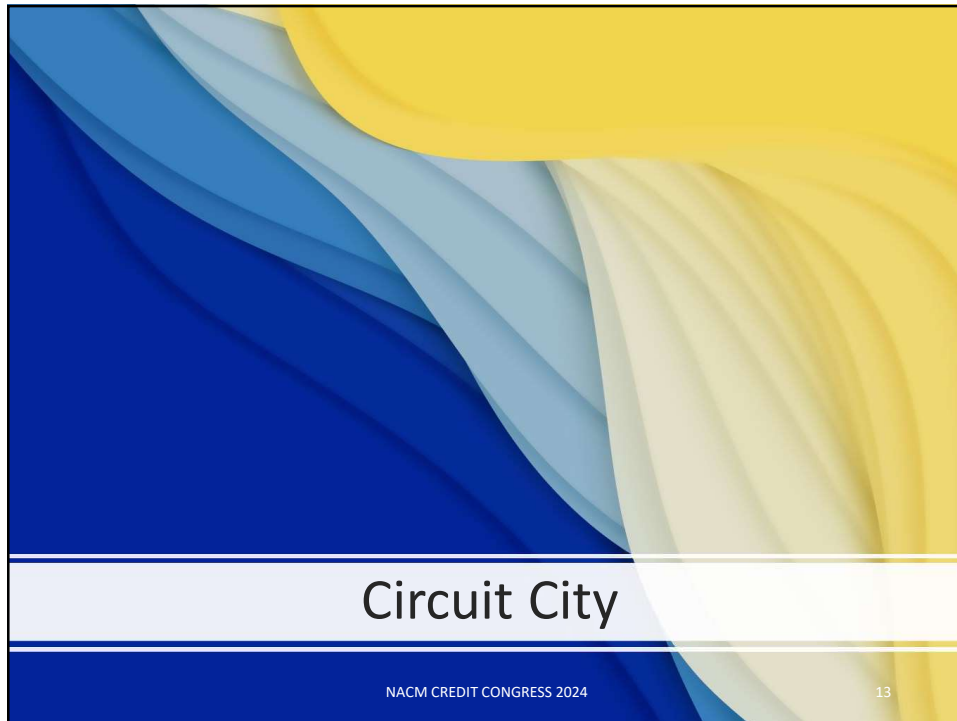
**U.S. District Court denied the stay**

**U.S. District Court compelled arbitration**

**Settlement was reached**

- **Each consignment creditor got paid proportionately to the extent of the validity of its consignment interest**

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**CIRCUIT CITY – DILIGENT CREDITORS CAN WIN THE DAY**

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- **MONITORING CREDIT LIMITS**
  - Credit Executive realized exposure to Circuit City was about \$100 million more than the authorized credit limit
  - Credit Limit was managed until reaching the \$20 million it was supposed to be

A photograph of a warehouse conveyor belt system with several cardboard boxes moving along the rollers.

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## CIRCUIT CITY – DILIGENT CREDITORS CAN WIN THE DAY

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- **CREDIT INSURANCE**
  - “Whole” - available for an entire portfolio
  - “Key Accounts” – select largest customers
  - “Single” – one specific customer
- **A “Put” may be available for highest risk account receivable**
  - More expensive than credit insurance
  - Contracted for a specific period of time



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## CIRCUIT CITY – DILIGENT CREDITORS CAN WIN THE DAY

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- **CASH IN ADVANCE**
  - Credit Insurance was cancelled
  - Even a “Put” was no longer available
  - Creditor had no choice but to sell ONLY on CIA basis
- **\$20 million in goods sold for the upcoming holiday season in August 2008**
  - **CAVEAT:** Invoices may need to be cut manually so terms are NOT automatically generated



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## CIRCUIT CITY – DILIGENT CREDITORS CAN WIN THE DAY

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- **PREFERENCE RISK**
  - Sometimes the risk is worth it
  - Creditor reduced a \$20 million exposure to < \$2 million by time of filing
    - Reduction took place over the course of 1.5 years
- Payments were mostly OCB with Preference Period
- CIA payment fully protected



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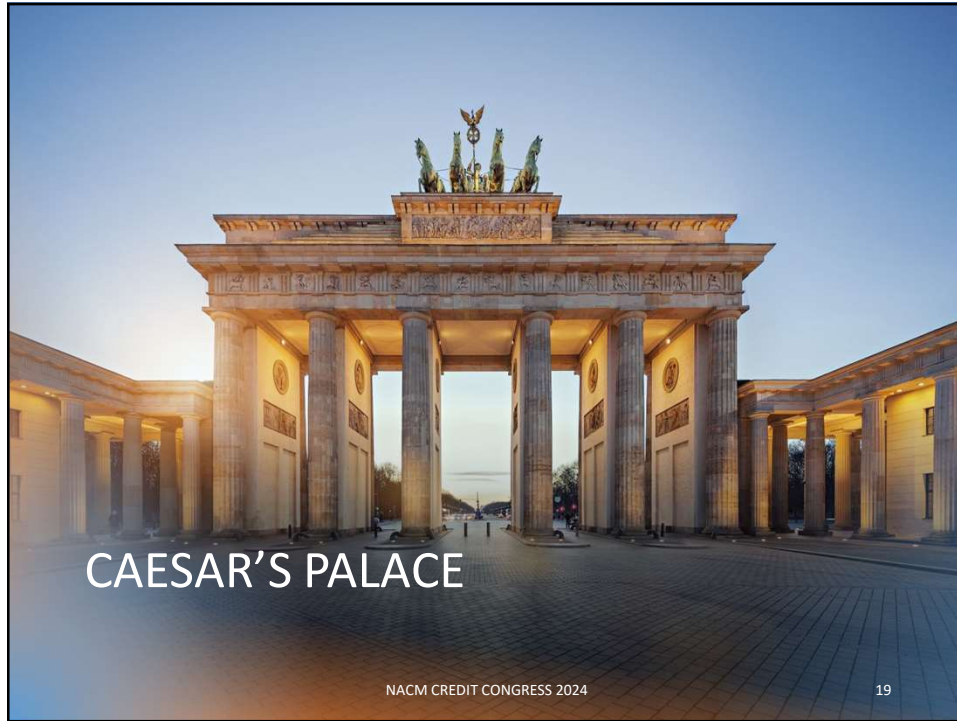
## CIRCUIT CITY – DILIGENT CREDITORS CAN WIN THE DAY

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- **PREFERENCE Claim**
  - \$37 million
    - Included the \$20 million CIA
  - New Value and OCB defenses were used for the \$17 million
- **Settlement**
  - Creditor had a claim of \$1.9 million
  - Claim waived in exchange for preference suit dropped



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## CAESARS PALACE – SOMETIMES THE HOUSE LOSES

- Apollo Global Management and TPG Capital bought what was Harrah's Entertainment for about \$31 billion—and renamed the entity Caesars Entertainment
- But the gaming industry had slowed, and so had the convention business
- Creditors alleged that the owners had taken all of the “good” properties and left Caesars struggling with debt

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## CAESARS PALACE – SOMETIMES THE HOUSE LOSES

- From the Financial Times: “Between 2011 and 2014, Caesars — at the behest of Apollo — began selling off portions of its intellectual property and Las Vegas properties including Planet Hollywood, Bally’s, Linq/Octavius, the Quad and the Cromwell. The buyers of all those assets: none other than entities controlled by Apollo and TPG.”

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## CAESARS PALACE – SOMETIMES THE HOUSE LOSES

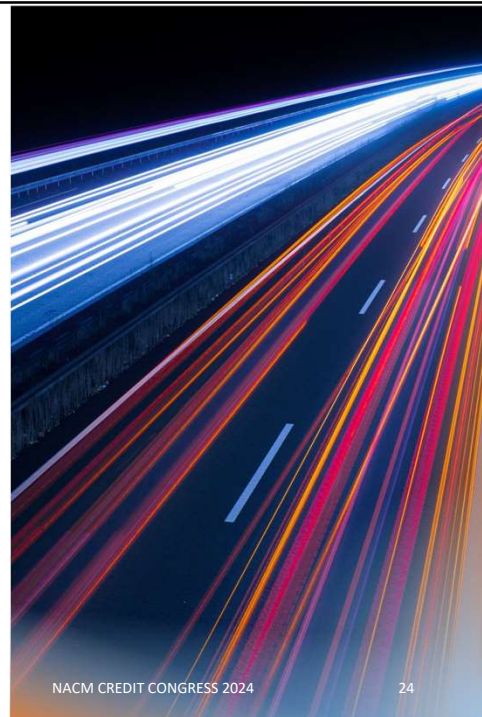
- But to me, that’s not the juiciest part: A financial consultant had a partner who was having an affair with someone at Caesars’s parent company.
- The bankruptcy judge rejected the consultant’s report and zeroed out the fees.
- Lesson: Disclose, disclose, disclose.

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## **UNIQUE PREFERENCE DEFENSES RAISED IN PONZI SCHEME CASE**

- **TransVantage Group Chapter 11**
  - **Transportation Services company provided audit services, among other things**
  - **TransVantage would audit transportation invoices**
  - **Moneys paid to TransVantage to be held in trust pending audit and clearance of invoices**
- **\$40 million “disappeared” from the trust account**
- **Principal pleads guilty to fraud**
- **Chapter 11 converted to Chapter 7**
  - **Trustee appointed**



## PREFERENCE ACTIONS COMMENCED BY CHAPTER 7 TRUSTEE

- Trustee sues more than 500 transportation companies for alleged preferential payments
- Although \$40 million is stolen from trust account, Trustee sues for more than \$600 million in alleged preferences and fraudulent transfers
  - Carriers who trusted TransVantage to reconcile invoices and disburse trust funds to them were sued
  - Customers of TransVantage were sued for moneys purportedly owed to TransVantage
- Joint Motion to Dismiss filed

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## MEETING THE DEFINITION OF A PREFERENCE UNDER 11 USC 547

- Property of the Estate
  - Funds transferred never belonged to TransVantage since TransVantage was a mere conduit
- Payments to or for the benefit of creditor
  - The Carriers were not creditors of TransVantage but were owed moneys from the Customers of TransVantage
- In payment of an antecedent obligation
  - The obligation existed between the Customers and the Carriers, not between TransVantage and the Carriers

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## CREDITORS WHO HELD OUT AND REFUSED TO PAY WERE THE MOST SUCCESSFUL

- Customers willing to settle with TransVantage and pay funds owed to the Carriers BUT ONLY IF ALL CLAIMS WERE RELEASED
  - Carriers would not receive 100%
  - The Trustee would receive funds for the Estate
- Most Carriers took the settlements
- Some Carriers refused and “dragged out the fight”
  - Those who held out the longest made the lowest settlements with the Trustee



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## KUMTOR GOLD COMPANY

## THE INTERNATIONAL CHALLENGE



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## Getting Paid on Post-Petition Goods or Services Rendered

- 11 U.S.C.365 – Executory Contract Assumption
  - Debtor does not always agree
- Critical/Essential Vendor Status
  - You may believe you are Critical – but are you?
- Think Outside the Box
  - When all else fails – get creative

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## Multiple Countries Involved

- Debtor located in Kyrgyzstan
- Debtor owned by Canadian Company
- Debtor's gold mine taken over by the Kyrgyz Government




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## The International Challenge

- Client headquartered in Australia 
- Corporate counsel located in Germany 
- Chapter 11 filed in New York 

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## Sleepness Nights

- Government wants equipment
- Debtor refuses to consent
- Client's query
  - Is it safe to ship?
  - Will the court hold it in contempt?
  - Who is going to pay for equipment?

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## Judge Barred from Kyrgystan???

- Case finally resolved
- NCBJ
- Judge's comments – 2021 and 2022

