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Retention of a Turnaround Firm

Section 363(b) vs. § 327(a): Which Statutes Apply?

To restore solvency, many troubled companies turn to turnaround practitioners who assist in identifying the reasons for failing performance and creating long-term strategic and restructuring plans to rectify their situations. Once a bankruptcy filing is involved, retention of such services must be approved by bankruptcy courts. This article discusses a recent opinion from the U.S. Bankruptcy Court for the Southern District of New York addressing an applicable and proper statutory basis for the retention of such a turnaround firm.

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Factual Background

In *In re Nine West Holdings Inc., et al.*,[1] Nine West Holdings and its affiliated debtors (collectively, "the debtors") filed an application to retain Alvarez & Marsal North America LLC (A&M) to provide the debtors with an interim CEO and certain personnel, and to designate Ralph Schipani as interim CEO.[2] The relief was sought under 11 U.S.C. § 363(b).[3] Yet, shortly thereafter, the Office of the U.S. Trustee filed an objection asserting that the employment of a turnaround professional must be done under 11 U.S.C. § 327(a), which requires that professional persons be "disinterested" persons.[4] As A&M and Schipani were not disinterested, the U.S. Trustee claimed that they could not be retained.[5]

A&M was not disinterested because, for more than four years, A&M had been providing critical management-type services to the debtors and its nondebtor affiliates.[6] A&M was retained to assist Jones Holdings LLC and Nine West Holdings Inc. in conjunction with an internal restructuring after their acquisition by Sycamore Partners LP.[7] Post-acquisition, the company's new board retained A&M to implement a new business plan.[8] Since April 2014, A&M had provided critical management services to the debtors and its nondebtor affiliates (*i.e.*, A&M was hired to manage day-to-day business operations and supplement traditional management functions).[9]

A&M was not hired to restructure the company's obligations, and nothing in the engagement letter concerned bankruptcy planning.[10] It was not until three years into the engagement that the company considered a possible bankruptcy filing (independent of the services being rendered by A&M).[11] Since the debtors' chapter 11 filings, A&M has continued to manage the daily operations of the debtors' business as it had done for the previous four years, with such work supporting the professionals retained by the debtors for purposes of its chapter 11 cases.[12]

Likewise, Shipani was not disinterested because, subsequent to A&M's initial retention and prior to the bankruptcy filing, Schipani served in several roles, including on the boards of subsidiaries of certain of the debtors, the appointments of which were made by boards of the debtors' parents.[13] The U.S. Trustee argued that A&M and Schipani were professional persons within the meaning of § 327 and employment of professional persons must be accomplished solely and exclusively under § 327. As A&M cannot meet the disinterestedness requirement of § 327(a), the U.S. Trustee claimed that the application had to be denied. Consistent with long-standing case law from multiple jurisdictions, Hon. **Shelley C. Chapman** disagreed by rejecting the U.S. Trustee's contention and overruled the objection.

Analysis

The court recounted the parties' positions. Citing to "numerous" decisions from the Southern District of New York and beyond, the debtors and A&M argued that A&M's retention, to include the appointment of key officers to manage the debtors' day-to-day business, was proper under § 363(b), while the U.S. Trustee, "seemingly ignoring this mountain of precedent," acknowl-

1 No. 18-10947 (SCC), 2018 WL 32389695 (Bankr. S.D.N.Y. July 2, 2018).
2 *Id.* at *1.
3 *Id.* Section 363(b) provides that after notice and a hearing, a trustee may use property of the estate "other than in the ordinary course of business." 11 U.S.C. § 363(b). "In determining whether to authorize the use, sale or lease of property of the estate under this section, courts require the debtor to show that a sound business purpose justifies such actions." *In re Montgomery Ward Holding Corp.*, 242 B.R. 147, 153 (Bankr. D. Del. 1999) ("In evaluating whether a sound business purpose justifies the use, sale or lease of property under § 363(b), courts consider a variety of factors, which essentially represent a business-judgment test."); *Myers v. Martin (In re Martin)*, 91 F.3d 389, 395 (3d Cir. 1996) (courts defer to trustee's judgment concerning use of property under § 363(b) when there is legitimate business justification); *In re Delaware & Hudson R.R. Co.*, 124 B.R. 169, 175-76 (D. Del. 1991) (courts have applied "sound business purpose" test to evaluate motions brought pursuant to § 363(b)).
4 *Id.* at *1-2. Section 327(a) provides that a trustee "with the court's approval, may employ one or more ... professional persons [who] do not hold or represent an interest adverse to the estate, and are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title." 11 U.S.C. § 327(a).
5 2018 WL 3238695, at *2.
6 *Id.*
7 *Id.*
8 *Id.*
9 *Id.*
10 *Id.* at *3.
11 *Id.*
12 *Id.*
13 *Id.* at *3-4.

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News at 11: Privacy Law Compliance in Bankruptcy

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Potential Roadblocks in Asset Sales

The sale of assets in bankruptcy is a valuable tool available to debtors to monetize assets to create liquidity in order to satisfy creditor claims. Unfortunately, GDPR compliance might thwart or slow down a sale of valuable personal data of a company's customers and other individuals. The "right to be forgotten" restrictions on transfers, and the limitations on a company's use of data outside of the original purpose provided to the individual, might make it difficult to effectuate a sale of the personal data. EU parties-in-interest could object at any time to a company's proposed sale of individuals' personal data. To ensure GDPR compliance, a court could require that a debtor provide notice to individuals in the EU informing them of their right to opt in or out of a sale of their personal data.

For asset sales made outside the ordinary course of business, § 363(b)(1)(B) requires that the court order the appointment of a disinterested privacy ombudsman upon the findings by the court — among other facts, that the debtor's pre-petition privacy policy prohibited the transfer of consumers' personal data[35] to nonaffiliate third parties, and the proposed sale is not consistent with the terms of the privacy policy.[36]

Where a debtor seeks to sell the personal data collected from someone in the EU, the sale of the data could be inconsistent with a GDPR-compliant privacy policy because the sale of the data might exceed the scope of the original purpose disclosed to the individual for the processing of his/her data by the company.

If § 363(b)(1)(B) applies, the court will not approve a sale of personal data unless the sale is consistent with the debtor's pre-petition privacy policy, or, after appointment of the ombudsman and notice and a hearing, the court finds, among other things, that the sale complies with the Bankruptcy Code and does not violate applicable law, including nonbankruptcy privacy law.[37]

EU supervisory authorities might possibly intervene in the bankruptcy sale proceedings in order to safeguard the privacy rights of EU subjects. U.S. federal and state regulators have previously intervened in bankruptcy sales to protect the privacy of personal data of U.S. consumers.[38] Accordingly, EU supervisory authorities' intervention in a U.S. bankruptcy is not a remote possibility. Any delay in the sale process resulting from enforcement of GDPR, including an ombudsman's compliance investigation, could dissuade prospective purchasers or lead to a lower sale price in those cases where the sellable assets are "melting ice cubes." abi

35 Personally identifiable information (PII) is defined in the Bankruptcy Code and includes a consumer's name, physical address, email address, phone number, Social Security number, credit card number, and birth certificate. *See* 11 U.S.C. § 101(41A). PII also includes "any other information concerning an identified individual that, if disclosed, will result in contacting or identifying such individual physically or electronically." *Id.*

36 *See* § 363(b)(1)(B).

37 *Id.*

38 *See, e.g.*, Kenneth M. Misken and Camisha L. Simmons, "Government Addresses Privacy Concerns in Bankruptcy Sales," XXXI *ABI Journal* 10, 28, 70-71, November 2012, *available at* abi.org/abi-journal.

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edged only a "limited" number of those authorities and tried to distinguish them as involving the appointment by a turnaround firm of an interim CRO, as opposed to A&M providing an interim CEO.[14] The court characterized the U.S. Trustee's attempted distinction as "nonsensical" and "illogical," and noted that in many of the 37 cases cited in A&M's reply brief, A&M was retained to provide various officers, not just CROs.[15]

The court also rejected the U.S. Trustee's reliance on footnote 3 of the so-called J. Alix Protocol, which provides that a financial advisor "shall not seek to be retained in any capacity in a bankruptcy proceeding for an entity where any principal, employee or independent contractor of [the advisor] serves or has served as a director of an affiliate thereto within two years prior to the petition date."[16] The cite to the J. Alix Protocol was based on Schipani's service as a director of one debtor entity within two years of the bankruptcy filing. However, the court found that this service concerned "ministerial duties," and approvals of actions that he previously vetted as an officer did not implicate the concerns of the J. Alix Protocol in the first instance: The exercise of undue influence over hiring the employee's firm.[17]

Finally, the court rejected the U.S. Trustee's contention that A&M and Schipani were "professional persons" as contemplated by § 327(a) because they "specialize in financial and operational restructuring" and were intimately involved in restructuring the debtors' business and were central to the reorganization, explaining that A&M was retained four years prior to the filing and that since its retention, Schipani and others at A&M have "managed the company, providing services that would be needed independent of any bankruptcy filing."[18] The court further explained that the roles of A&M and Schipani, both before and after the bankruptcy filing, are focused on running the business. The

14 *Id.* at *4-5. The court referred to four decisions, some of which cited to multiple other decisions approv- ing the retention of turnaround firms that provide officers (*i.e.*, CEOs, CROs, CFOs, etc.) as interim management under § 363(b). The orders approving such retentions in the Southern District of New York and the District of Delaware, among other districts in the nation, are legion. *See also, e.g., In re Adinath Corp., et al.*, No. 15-16885-BKC-LMI (Bankr. S.D. Fla. May 8, 2015); *In re Tuscany Int'l Holdings (U.S.A.) Ltd.*, No. 14-10193 (KG) (Bankr. D. Del. March 20, 2014); *In re Archbrook Laguna Holdings LLC*, No. 11-13292 (SCC) (Bankr. S.D.N.Y. Aug. 3, 2011); *In re Harry & David Holdings Inc.*, No. 11-10884 (MFW) (Bankr. D. Del. April 27, 2011); *In re Med. Staffing Network Holdings Inc., et al.*, Case No. 10-29101-BKC-EPK (Bankr. S.D. Fla. July 22, 2010); *In re Spansion Inc.*, No. 09-10690 (KJC) (Bankr. D. Del. April 13, 2009); *In re Calpine Corp.*, No. 05-60200 (BRL) (Bankr. S.D.N.Y. Jan. 17, 2007); *In re Dana Corp.*, Case No. 06-10354 (BRL) (Bankr. S.D.N.Y. March 29, 2006).

15 2018 WL 3238695, at *5 (listing interim CEO, CFO, COO and vice president of finance positions, citing decisions from Southern District of New York, Southern District of Texas and District of Delaware). The court asked the following question: "Is the U.S. Trustee's position that retention of a CRO can be authorized under § 363 but the retention of a CEO cannot?" *Id.* As alluded to by the court, there is simply no principled basis for taking such a position, and none was offered by the U.S. Trustee.

16 *Id.* at *6-8.

17 *See id.*

18 *Id.* at *10.

services that they provided to support the debtors' bankruptcy-specific professionals were largely work that the officers and managers of any bankrupt entity would have to do in the ordinary course. It would be an absurd result if their work in such roles was sufficient to render them as "professional persons"; if this were the case, virtually every senior executive of every chapter 11 debtor would have to be retained under § 327(a).

This simply cannot be.[19] In short, given the very substantial authorities from across the nation, including the Southern District of New York and District of Delaware, a chapter 11 debtor seeking to retain a turnaround firm should be able to do so under § 363(b).

Conclusion

In overruling the objection based on a purely technical argument, the bankruptcy court emphasized the importance of preserving the value of a debtor's business, which is best accomplished by permitting the debtors to utilize their assets under § 363. Ruling to the contrary — sustaining the objection — would require new management hiring, leading to a loss of gained critical experience and institutional knowledge (none of which can be replaced easily or quickly). Such an outcome could cause a disruption of business operations and jeopardize chapter 11 reorganization and restructuring: the sole purpose of a bankruptcy filing.

Therefore, similarly situated debtors, following a bankruptcy filing, might continue to rely on professionals who played vital roles in managing the debtors' day-to-day and strategic operations and provided management stability prepetition without fear of the § 327(a) exclusion. On a side note, in many instances, turnaround firms are (unlike in *Nine West Holdings*) retained shortly before a bankruptcy filing. In those cases, there might be a better argument to make that the turnaround firm and any officer it would appoint a "professional person" as contemplated by § 327(a). abi

19 *Id.* at *10-12 (citing *In re SageCrest II LLC*, Nos. 3:10CV978, 3:10CV979, 2011 WL 134893, *7 (D. Conn. Jan. 14, 2011), for proposition that "[o]fficers responsible for the day-to-day business of the debtor ... stand in contract to professionals hired for the sole purpose of reorganizing the debtor organization") (emphasis added by *Nine West Holdings* court; additional citations omitted).