AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
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# Navigating the Pitfalls of Chapter 11 Deposit Management

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While it might seem straightforward on the surface, managing bank accounts and deposits for entities engaged in corporate restructuring or other complex legal and financial matters can be fraught with many potential perils and missed opportunities. Each case brings its own specific depository needs and circumstances that require knowledge and strategic resolution. The complexity of balancing interest rates, deposit terms, collateral, Federal Deposit Insurance Corp. (FDIC) insurance and other considerations makes deposit management as much an art as a science.

Of all the skills brought to bear in a chapter 11 matter, treasury-management skills are perhaps the most often overlooked. Nonetheless, each chapter 11 team of professionals should include someone with this skill set. Professionals can avoid common pitfalls by broadening their understanding of the ins and outs of deposit management, and by following best practices as they consider the many aspects of the process from the onset of a corporate-restructuring matter through to final distribution of deposited funds. Managing deposits strategically and successfully can enhance a debtor's legal posture, protect assets of the estate and add value to the estate, resulting in greater recoveries for all stakeholders and involved parties.

## Understanding § 345 and FDIC Insurance in Chapter 11

Large companies initiating a bankruptcy strategy typically already have an established banking system. Whether the existing system survives the early stages of a chapter 11 case depends largely on the professionals' approach and their execution of the requirements of § 345 of the Bankruptcy Code.[1]

Section 345(a) requires that deposits or investments of money of a bankruptcy estate, such as cash, be made so as to "yield the maximum reasonable net return on such money, taking into account the safety of such deposit or investment."[2] Section 345(b) requires that deposits or investments that are not "insured or guaranteed by the United States or by a department, agent or instrumentality of the United States or backed by the full faith and credit of the United States" be backed by a bond in favor of the U.S. secured by the undertaking of an adequate corporate surety.[3]

It is not uncommon for debtors to file, as part of the first-day motions at the beginning of a chapter 11 case, a "cash-management motion" that requests waiver of the § 345(b) requirements, at least on an interim basis.[4] Waiver can be granted "for cause," and the most widely accepted test for cause is laid out in *In re Serv. Merchandise Co. Inc.*[5] In this case, the court set out a 10-part test to determine whether "cause" exists for a waiver, including the following factors: (1) the sophistication of the debtor's business; (2) the size of the debtor's business operations; (3) the amount of the investments involved; (4) the bank ratings

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1 All references to sections herein are to sections of the Bankruptcy Code, 11 U.S.C. §§ 101-1532, as amended.

2 Section 345(a) provides that "[a] trustee in a case under this title may make such deposit or investment of the money of the estate for which such trustee serves as will yield the maximum reasonable net return on such money, taking into account the safety of such deposit or investment."

3 Section 345(b) provides that "Except with respect to a deposit or investment that is insured or guaranteed by the United States or by a department, agency, or instrumentality of the United States or backed by the full faith and credit of the United States, the trustee shall require from an entity with which such money is deposited or invested — (1) a bond — (A) in favor of the United States; (B) secured by the undertaking of a corporate surety approved by the United States trustee for the district in which the case is pending; and (C) conditioned on — (i) a proper accounting for all money so deposited or invested and for any return on such money; (ii) prompt repayment of such money and return; and (iii) faithful performance of duties as a depository; or (2) the deposit of securities of the kind specified in section 9303 of title 31; unless the court for cause orders otherwise." Section 354(b) was added to the Bankruptcy Code in 1994, overruling *In re Columbia Gas Sys. Inc.*, 33 F.3d 294 (3d Cir. 1994).

4 *See, e.g., In re Brookstone Holdings Corp.*, Case No. 14-10752 (BLS) (Bankr. D. Del. April 4, 2014); *In re LightSquared Inc.*, Case No. 12-12080 (SCC) (Bankr. S.D.N.Y. May 15, 2012 (interim order), and June 11, 2012 (final order)).

5 *In re Serv. Merch. Co. Inc.*, 240 B.R. 894 (Bankr. M.D. Tenn. 1999).

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(Moody's and Standard and Poor) of the financial institutions where debtor-in-possession (DIP) funds are held; (5) the complexity of the case; (6) the safeguards in place within the debtor's own business of ensuring the safety of the funds; (7) the debtor's ability to reorganize in the face of a failure of one or more of the financial institutions; (8) the benefit to the debtor; (9) the harm, if any, to the estate; and (10) the reasonableness of the debtor's request for relief from § 345(b) requirements in light of the overall circumstances of the case.

One significant area of consideration at this early stage is the role of insurance provided by the FDIC[6] and collateral. Section 345 and related statutes require trustees (including DIPs) to acquire collateral for estate deposits either in the form of a surety bond or in the form of "securities of the kind specified in section 9303 of title 31" of the U.S. Code. Section 9303 provides that an "eligible obligation," which can be provided in lieu of a surety bond, shall "(1) be given to the official having authority to approve the surety bond; (2) as determined by the Secretary of the Treasury, have a market value that is equal to or greater than the amount of the required surety bond; and (3) authorize the official receiving the obligation to collect or sell the obligation if the person defaults on a required condition."

"Eligible Obligations" means any security designated as acceptable in lieu of a surety bond by the Secretary of the Treasury,[7] and regulations issued by the Treasury Department explain that "eligible obligations" are transferable securities reflecting "public debt obligations of the United States Government whose principal and interest are unconditionally guaranteed by the United States Government."[8] This demand for collateral with the highest punctilio of security has the unfortunate consequence of making such collateral very expensive; generally, the estate bears the expense in the form of reduced interest rates or other less productive banking terms. However, counsel focused on efficient operations and utilizing experts with strong depository management skills can often seize opportunities to reduce collateral, thus allowing debtors to gain greater terms elsewhere (*e.g.*, banks might pay greater interest if they do not have to post collateral or might provide other helpful services without charge).

As one of many examples, a trustee might use multiple banks to reduce the collateral requirements. This article only describes this process at the 30,000-foot level, but in short, FDIC insurance replaces the need for collateral on the first $250,000 in each debtor's bank, although the bank or debtor must collateralize the funds at such bank beyond that amount. However, by using multiple banks, a debtor could deposit $250,000 in each bank and thereby gain FDIC insurance on $250,000 multiplied by the number of banks. This is referred to as "bank syndication." An example of this would be a syndicate of 40 banks that allow for $10 million of FDIC-secured deposits, removing the cost of collateral on such amount. As each of these banks generally must be on the approved bank list promulgated by the respective region's U.S. Trustee,[9] and the estate likely will want to avoid numerous banking statements every month, trustees can best execute on these strategies by utilizing an expert in depository services.

In many cases, trustees' counsel will seek relief from § 345, removing the collateral requirements. While this resolves the collateral requirements, the balancing act remains — and now the estate professionals must give much greater consideration to the credit strength of the depository institutions. Even with relief from § 345, there will always be a handful of elements to balance in selecting and negotiating with depository institutions.

## Banking Solution Elements to Consider

As debtors and their professionals move forward in considering depositary options, interest rates represent just one piece of the puzzle when it comes to the art of deposit management. Here is an abbreviated list of some of the relevant elements to consider when reviewing bank and account options, and questions related to each:

- *Collateral*. Does the court require it? If so, who is paying for it: the bank, the debtor or a third party? If not, are the debtor's professionals comfortable enough with the bank's credit to sleep at night without collateral?
- *Bank*. Is the bank rated? If not, how comfortable is the debtor with the bank's credit?
- *Deposit Terms*. Are the funds available for withdrawal on demand? If the debtor does not need 100 percent liquidity, can the debtor receive a higher interest rate by locking some of the funds up for a set term?
- *Technology*. Does the bank integrate its banking system with helpful bankruptcy-related technology?
- *Account Types*. What are the debtor's expectations with respect to bank transaction volumes? Will the debtor perform wires or have high-volume banking operations that give rise to material banking fees?
- *FDIC Syndication and Multiple-Debtor Estates*. Can the debtor avoid the cost of collateral by spreading deposits across many banks? Is the debtor's case one of multiple consolidated debtors that would allow each bank to hold funds in multiple TINs (*e.g.*, if four debtors filed collectively, could they collectively hold $1 million in each of the syndicated banks)?
- *Credits*. Does the bank offer credit against bank fees in addition to or instead of interest payments?
- *Flexibility*. Do bank executives exercise outside-the-box thinking, or do they stay within their well-defined lines? Navigating bankruptcy situations can require flexible, strategic thinking, and debtors might need creative banking partners who are open to innovative solutions.

The art of the process emerges when analyzing how all factors could play against each other and in finding the right blend for each deposit. Professionals should apply a

6 The FDIC is an independent agency of the U.S. government that provides deposit insurance to the depositors of a failed FDIC-insured depository institution dollar-for-dollar, principal plus any interest accrued or due to the depositor, through the date of default, up to at least $250,000. *See, e.g.*, "Deposit Insurance FAQs," FDIC (last updated Jan. 31, 2018), *available at* fdic.gov/deposit/deposits/faq.html (unless otherwise specified, all links in this article were last visited on Feb. 22, 2019).

7 31 U.S.C. § 9301(2).

8 *See* 31 C.F.R. Part 225.2.

9 *See, e.g.*, "Office of the United States Trustee Approved Depositories — Region 16 (as of April 2, 2018)," *available at* justice.gov/ust-regions-r16/file/approved_depositories.pdf/download; "Region 21 Authorized Depositories (Revised Nov. 14, 2018)," *available at* justice.gov/ust-regions-r21/file/ad_sdfl.pdf/download.

high level of scrutiny to bank ratings and credit as a potential replacement for costly collateral, but higher-rated banks tend to pay lower interest rates, so the debtor must strike a balance.

Chapter 11 reorganizations often involve unusual elements that challenge this balance. In one example involving a large international Ponzi scheme, the debtor's professionals utilized a combination of (1) proprietary technology specifically designed to streamline the complex claims-administration process, and (2) depository service experts to customize workflows to manage the myriad claim calculations and distributions. This powerful combination of tailored technology and professional expertise resulted in time and cost efficiencies, and ultimately in the relatively speedy distributions of more than $175 million to creditors.

## Managing the Depository Needs of Foreign Entities

Cross-border insolvencies bring added challenges and opportunities when it comes to deposit management. Foreign entities engaged in legal proceedings must have physical property, cash or bank accounts in place to establish venue and meet jurisdictional requirements.[10] Timeliness plays a critical role in this process, and the right deposit-management strategy can make the difference, especially when debtors need operational bank accounts on short notice.

Among other challenges, the know-your-customer requirements can make the process of opening bank accounts cumbersome and time-consuming.[11] At these times, if the debtor's professionals have strong relationships with banks, those banks might be willing to minimize delays and overcome obstacles. Again, smaller banks might often have greater flexibility or might take a more creative, entrepreneurial approach to international challenges.

## Best Practices in Deposit Management

In every aspect of deposit management, whether it be for cross-border or domestic bankruptcy matters, certain fundamental principles and best practices can serve as a guide.

- *Enlist knowledgeable and experienced experts.* As many corporate restructuring attorneys do not have hands-on experience in managing the details of these financial matters, they should enlist the support of professionals who have expert knowledge and specialized technology to stay on track with their clients' deposit-management goals.
- *Understand the relevance and role of timing and lateral mobility.* Managing deposits is more than just a "set and forget" exercise. It is important to allow for flexibility and latitude to consider other options when needed and to know when the right time is to take action or change the plan. As bankruptcy matters evolve, so must the banking strategies.
- *Do not underestimate the value of customer service.* Given the demands of running chapter 11 cases, trustees and their professionals need a client-service team around the clock. Banks often cannot offer this type of service, but some professional service providers will offer banking services whenever you need them, 24/7.

Few, if any, professionals have every skill necessary to navigate the chapter 11 landscape without assistance from other professionals. In reviewing depository-management options, professionals must exercise treasury-management skills, but not all professionals have the requisite treasury training. Every chapter 11 team should include someone with this training, as proper execution of depository strategies in a chapter 11 can yield great results, ranging from establishing venue to protecting estates assets to expanding estate distributions. abi

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10 11 U.S.C. § 109(a); *see generally In re Aerovias Nacionales de Colombia S.A. (In re Avianca)*, 303 B.R. 1, 9 (Bankr. S.D.N.Y. 2003).

11 "Know your customer" requirements are established by the Financial Crimes Enforcement Network, an agency within the U.S. Treasury Department. *See* "Customer Due Diligence Requirements for Financial Institutions," 81 *Fed. Reg.* 29398 (May 11, 2016) (to be codified at 31 C.F.R. pts. 1010, 1020, 1023, 1024 and 1026), *available at* govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf.