Everyone Loves Found Money: Maximizing Recovery Using "Found-Money Assets"

Written by:
David Linn
Oak Point Partners; New York
david@oakpointpartners.com

For most bankruptcy estates, the typical approach to asset recovery has been to focus exclusively on core assets – fresh accounts receivable, large-balance preference claims, inventory, real estate, and maybe the occasional "hope certificate" litigation matter. However, it is becoming increasingly advantageous to identify and pursue recoveries from a range of less obvious areas that can generate meaningful liquidity. As these valuable, but often overlooked, assets create significant "Found Money" for bankruptcy estates, we now refer to them as "Found-Money Assets" or "FMAs."

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Bankruptcy professionals should focus on Found-Money Assets in an effort both to fulfill the fiduciary duty to explore recovery opportunities and, in many cases, to significantly move the needle in terms of ultimate payout to creditors. Since the volume of mid- and large-sized bankruptcy filings has been relatively low in 2005 and the first part of 2006, right now is a golden opportunity for professionals to review older cases originally filed in 1999 to 2004.

Although there are some common areas to review for FMAs, the key to success is tied to the creativity of the professional, requiring an eye for hidden value and an ability to think outside the norm. In this article, we aim to highlight several common areas for FMAs, as well as touch upon examples of hidden opportunities that may be illustrative of ways to generate additional cash in your cases. These areas include:

- Highly Aged and Written-Off Accounts Receivables
- Small-Balance Preference Claims
- Default Judgments from Preference Claims
- Bankruptcy Trade Claims held by Estates
- Class Action Settlement Claims
- Dividend Payouts or Rights to Future Distributions
- Others such as Trade Credits, Double/Over Payments, Vendor Deductions, Litigation Rights, and more

About the Author

David Linn is a vice president with Oak Point Partners, a purchaser of preference defaults and commercial receivables.

Highly Aged and Written-Off Accounts Receivables

The lowest hanging fruit on the Found-Money Asset roadmap is the highly aged and written-off receivables. Although most collections efforts focus on the fresh receivables, more than 90% of distressed companies and bankruptcy estates have significant write-offs from two, three, and even four years ago that should be considered in any recovery strategy.

The first step in identifying the opportunity to turn highly-aged receivables and historical write-offs into cash is to gather an aging schedule that lists the outstanding receivables. However, any such schedule is likely to show only part of the picture because many times upon initial inspection, the accounts receivable (A/R) can look pretty clean. Further digging often reveals an interesting insight – the A/R looks clean because the company had routinely written off accounts, which often don't even show up any longer as a footnote on the aging schedule! After identifying the potential opportunities, there are three basic options to capture them: collect internally, outsource on a contingency basis to a specialty firm, or sell for cash.

Collecting internally works well in the limited number of cases when resources are available internally and adept at taking a proactive, problem-solving approach. Far too often though, restructuring professionals make the mistake of assuming that the company's credit and collections personnel are well-suited for such activity, but these employees had limited success at collecting these receivables initially, and they are unlikely to find alternative paths to success now.

Outsourcing on a contingency basis is another option if resources to collect internally are limited. Many professionals have existing relationships with collection agencies that perform well on accounts less than a year old, but struggle with commercial accounts that are 1 to 4 years old, and they often won't even apply much effort toward these older accounts. Aged receivables and historical write-offs have limited documentation and are rife with disputes. It takes a specialized agency to have success with these types of accounts, particularly the prior write-offs.

Finally, selling for cash is an option if time, simplicity, or short-term liquidity issues are the key considerations. This is a common and straightforward process in the relatively uniform world of consumer debt. However, in the case of written-off commercial receivables, firms willing to pay cash are far fewer in number. A key reason for the difference is that credit card portfolios have common characteristics, whereas commercial receivables tend to have unique attributes from one company to the next. For instance, credit applications can differ dramatically, as do ordering forms, invoices, and proofs of delivery. Purchases of aged commercial receivables typically include a short timeframe for recourse by the buyer on accounts deemed invalid, shifting into a non-recourse situation thereafter. Depending on pricing and documentation, the sale can sometimes even be done on a modified as-is, where-is basis with limited representations by the seller.

Small-Balance Preference Claims

Another Found-Money Asset is the small-balance preference claims, particularly when considering the potential impact of The Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"). Even

prior to BAPCPA, many professionals did little more than send a demand letter or two on the small balance preference claims. Typically, it was pre-determined that no suits would be filed on matters below an arbitrary pre-selected size, so little attention was paid to such cases.

As an alternative, these can be considered Found-Money Assets, particularly when a specialty commercial collections agency that understands the preference laws pursues these monies on a purely contingency basis, and (under BAPCPA) has the capacity to bring and prosecute suits in the vendor/defendant's local jurisdiction when necessary.

Default Judgments Stemming From Preference Claims

Any practitioner knows that in just about every case with preferences, a percentage of the preference suits end up as default judgments. These default portfolios sit and atrophy, but are actually a potential source of Found Money. Fatigue and inertia work against these defaults, as it's believed that they have been pursued extensively, first via the demand efforts and then via the entire suit process.

Since many of the files are "dead," it no longer makes sense to continue to invest in hourly fees to work them. However, that does leave two viable options for generating cash from the defaults: either outsource on a contingency basis or sell for cash.

For preference defaults, outsourcing on a contingency basis can be a good option if the estate is not in a hurry to wrap up because you get the benefit of potential cash recovery without incurring additional costs. However, if you don't outsource to the right type of firm, then you will have wasted your time and not generated any Found Money. Specifically, you need to hire an agency or recovery group that has significant expertise in collecting defaults, as the required skill set is quite different from traditional collections work. Additionally, the partner you hire should have access to counsel in the defendants' local jurisdictions to domesticate efficiently and pursue judgments when amicable resolution is impossible.

Selling defaults for cash is a second good option for the estate, trustee, or committee. With this approach, you can quickly generate a fixed payment of cash and gain closure on these assets. Typically, the sale of defaults is completed on a largely as-is, where-is basis with only nominal representations by the seller. The process tends to be simple and easy as well with the buyer turning around a purchase proposal in as little as one day after reviewing a list of the defaults. Further, the seller may also secure a commitment that requires the buyer to obtain a section 502(h) waiver from any paying or settling defendant.

For example, in the ACT Manufacturing, et al. case, the Liquidating CEO (LCEO) and his counsel together determined that the cost/benefit equation of having counsel continue to pursue the defaults didn't make sense, so the LCEO sought a sale to generate Found Money for the estate. The LCEO sold a portfolio of defaults to Oak Point Partners in 2005 on an all-cash "as-is, where-is" basis, and then sold a second portfolio to Oak Point in 2006 as the case approached closure. Both transactions provided cash to the estate that would not otherwise have been generated for creditors.

Bankruptcy Trade Claims held by Bankruptcy Estates

FMAs can come in all shapes and sizes. An overlooked FMA can be found with bankruptcy trade claims held by bankruptcy estates. These assets are ignored because they have little to no expected payout or the payout will be at some unknown time in the future.

Traditional claims buyers typically structure deals on a recourse basis with the ability for the buyer to unwind the transaction under a number of future scenarios. Of course, this recourse clause is not a viable deal term when purchasing from a bankruptcy estate, thereby minimizing the interest on the part of the traditional buyers. However, a limited number of firms are willing to purchase such claims on a non-recourse basis, thereby accepting the risks and complexities associated with buying claims from bankruptcy estates.

Class Action Settlement Funds

Participation in recoveries from class action settlements is an excellent Found-Money Asset for bankruptcy estates. One such example is the VISA/MasterCard settlement, in which VISA and MasterCard have agreed to refund over $3 billion to merchants in settlement of a lawsuit filed by Wal-Mart and other retailers. Any business that accepted VISA or MasterCard between 1992 and 2003 is entitled to a share of the settlement fund. There are firms that work to assist estates in identifying the potential for recovery, with some of these firms willing to pay cash to purchase the rights to future payouts.

Dividend or Co-op Payouts

We previously pointed out the importance of thinking creatively to identify Found-Money Assets. One of the best examples of this took place in a recent case, where a firm specializing in FMAs did some sleuthing, ultimately discovering that the estate was entitled to a payout from a utility co-op. The firm learned that the co-op would begin making dividend payouts the following year and that the estate was entitled to ten years' worth of such payouts. Now, of course, the estate would not be around to collect that payout in another year, let alone in ten years. However, it was determined that this was a transferable asset, enabling the estate to sell this FMA in exchange for a nice upfront payment.

Of course, not every bankruptcy estate will have rights to co-op dividends, but they might have other opportunities, such as trade credits for returns, double/overpayments, vendor deductions, non-traditional litigation claims, and the like. Again, a bit of research and creative thinking will help to uncover a wide array of FMAs in most estates.

Conclusion

Who doesn't like Found Money? Certainly, the more recovery that can be generated into bankruptcy estates, the better, particularly after the "low hanging fruit" is picked. In fact, these extra recovered funds might not only have an impact on the ultimate percentage recovery for the estate, but the enhanced performance and the perception of trying to go the extra mile for creditors will have a positive impact for the professionals in their efforts to get hired on future cases.

Our list of Found-Money Assets, or FMAs, is in no way a comprehensive list. Every case is different with varying opportunities and limitations. However, we believe that this roadmap should guide professionals to areas to explore within their cases as well as to third parties that can help with either the identification or monetization of such opportunities. ■