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The Mutual Benefits of Trust

Building an Attorney-Client Relationship in Collections Work

By Brett Boehm

Let's face it: Collections work is not for every attorney. But it has been my experience that with a commitment to some fundamental operating principles and a focus on building a mutually beneficial relationship, both the collections attorney and his or her client can develop and maintain a long-term working relationship that really is, for all intents and purposes, a partnership.

Of course, I am coming at this from a client's perspective: My company buys commercial debt, primarily from equipment leasing companies, banks and other asset-based lenders that have decided not to attempt to recover it — or perhaps attempted but were unsuccessful. We purchase these debts after they have been "charged-off" by the leasing company or other lender who has decided that its best hope for collecting any return from these charge-offs is to sell them to us.

When my partners and I founded our company 15 years ago, we knew the key to making

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Con Ed Reversal Ends LILO/SILO Saga — And Then Some

By Philip H. Spector

In January, the U.S. Court of Appeals for the Federal Circuit handed down its decision in *Consolidated Edison Company of New York, Inc. v. United States*, No. 2012-5040 (Fed. Cir. 2013), *rev'g* 90 Fed. Cl. 228 (2009). *See LJN's Equipment Leasing Newsletter* Sept. 2008, Oct. 2008 and Jan. 2010. The decision reverses the only lower court case that had decided a LILO or SILO transaction in favor of the taxpayer, and likely ends the decade-long litigation of these contentious leveraged lease cases. While the reversal was not unexpected in light of recent appellate cases disallowing LILO/SILO tax benefits, the decision has had the, perhaps, unintended effect of calling into question the use of lessee fixed-price purchase options in sale-leasebacks and other more conventional equipment leasing transactions.

In a typical LILO, the taxpayer, acting through a grantor trust, leases assets from a tax-exempt entity (*e.g.*, a domestic municipal transit agency or a foreign entity not subject to U.S. income taxation) under a primary or "head" lease. A SILO transaction is similar, except that the head lease term is deliberately structured to extend beyond the remaining useful life of the asset, so that it is treated as a sale for tax purposes. At closing, the taxpayer will make a significant payment to the lessee, either the purchase price for the property (in a SILO) or a partial prepayment of its head lease. The taxpayer then leases the property back to the tax-exempt entity under a net lease, where the lessee retains substantially all rights and responsibilities to use and maintain the property during the lease term.

At the end of the lease, the lessee may exercise an option to acquire the taxpayer/lessor's interest in the property. The exercise price is a fixed amount determined at the inception of the transaction based on an appraisal. The price is equal to or greater than the property's projected fair market value at the lease expiration date. If the lessee does not exercise its option, what happens next varies from LILO to SILO. With a LILO, the taxpayer/lessor typically may compel the lessee

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it succeed would be found in building and developing a network of attorneys who could represent our interests. Nothing we have learned in the past decade and a half has convinced us that there is any greater priority to our ongoing success than hiring, cultivating and compensating the best attorneys we can find. Our ultimate return is only as good as the efforts of our attorneys. Therefore, building a partnership with them and earning their loyalty are key factors in our success.

I'd like to share some of what we've learned about how building this kind of mutually beneficial relationship with our attorneys has been a key component of our success — and theirs.

Hiring a Partner

Our most successful relationships begin with the "hiring" of our attorneys. No, the attorneys who represent us all across North America are not, in fact, our employees; they are independent subcontractors who handle the local litigation associated with our claims. We maintain a database of attorneys throughout the country so we have one at the ready in most jurisdictions of each state.

It goes without saying that our attorneys must have expertise in the area we're looking to hire them for: collections litigation and judgment recovery. We always want to verify that any attorney we hire primarily or exclusively handles our type of work. Ideally, we want an attorney who deals exclusively in collections, not a general practitioner who is one day doing real estate closings, the next day doing estate planning, and maybe rounding out his or her week with civil litigation.

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Collections litigation is a specialized area of the law, and, while clients certainly welcome new attorneys who are eager to immerse themselves in it and learn its intricacies, they will expect a full-time commitment to learning and applying what they've learned. Most clients cannot afford to have an attorney who is "just testing the collection waters" to see if it's right for him or her; they most prefer someone fluent and experienced in collections work or, at the very least, committed to focusing solely on learning it.

Helping to Build a Working Relationship

Beyond this specific focus, every attorney has his or her individual strengths, preferences and quirks, and our staff recognizes these and uses that knowledge to allow us to work best together. In short, our company's staff makes sure our attorneys stay on the ball and that nothing falls through the cracks. They also make sure that the attorney gets quick responses and all materials necessary for resolving a claim in a prompt manner upon request. Once a matter is resolved, they account for all the costs and fees and confirm receipt of the requisite proceeds.

One critical area a client will always look into when hiring an attorney is to see that the attorney's office is organized in such a way as to work best for the client. The simple question is: "Is the attorney set up to take on your type of work?" While any responsible client will make every effort to organize cases and supporting documentation as thoroughly as possible, we look for attorneys who have a robust enough infrastructure and support staff in their office to enable them to work efficiently.

Frankly, a sole practitioner who doesn't have support staff is not going to be happy with our files because we're dealing in volume. If that lone attorney is the one preparing and organizing the documents, doing the initial research, drafting the complaints, and doing all the detail work, he or she is not going to be able to make enough money to cover his or her time.

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The Scope of Indemnification In DIP Financing Agreements

The Effect of Pre-Petition Indemnification Provisions

By Thomas Fawkes and Elizabeth L. Janczak

In filing for bankruptcy, one of the most important decisions a debtor makes is with regard to debtor-in-possession ("DIP") financing. Typically, a debtor negotiates with its pre-petition lender who then finances the Chapter 11 case. In return, the lender is granted certain protections from the debtor ranging from superpriority administrative expenses to adequate protection replacement liens to indemnification of the lender under certain circumstances.

The typical DIP financing indemnification provision applies only to the post-petition financing agreement. However, some lenders have insisted upon indemnification for pre-petition acts as well. This article examines the typical DIP financing indemnification provision and the less frequently seen pre-petition indemnification provision, and examines the effect of pre-petition indemnifications on the bankruptcy estate.

Typical Indemnification Provisions

Not all DIP financing agreements have indemnification provisions. For those agreements that do contain indemnification provisions, a debtor must usually indemnify the lender and hold it harmless from losses, claims or expenses that the lender may incur with respect to the DIP financing agreement and related documents. *See, e.g., In re N.Y. Chocolate & Confections Co.*, 10-30963 (Bankr. N.D.N.Y.), ECF No. 8-1; *In re Bedford Commc'ns, Inc.*, 10-10902 (Bankr. S.D.N.Y.), ECF No. 7-1; *In re WorldSpace, Inc.*, 08-12412 (Bankr. D. Del), ECF No. 87-1, 87-2, 87-3.

Indemnification for Pre-Petition Conduct

At least three cases in recent years have extended lender indemnification to pre-petition conduct. However, the indemnification provisions in each were accomplished in different ways.

The DIP financing agreement in *In re Ames Department Stores, Inc.* provided that certain pre-petition letters of credit were to continue, essentially rolling all pre-petition obligations into the post-petition obligations. *In re Ames Dept. Stores, Inc., et al.*, 01-42217 (Bankr. S.D.N.Y.), ECF No. 6-1. These obligations were subject to further terms, including an indemnification provision that provided that the debtors:

> shall jointly and severally indemnify and hold harmless each of [the lenders] … from and against any and all suits, actions, … and expenses … that may be instituted or asserted against or incurred by any such Indemnified Person as the result of credit having been extended … and in connection with or arising out of the transactions contemplated hereunder and thereunder … arising out of or incurred in connection with disputes between or among any parties to any of the Loan Documents … *Id.* at § 1.13.

Similarly, in *In re Crdentia Corp.*, the debtors and the pre-petition lender entered into a ratification of the pre-petition credit agreement in lieu of a newly executed post-petition agreement, *In re Crdentia Corp., et al.*, 10-10926 (Bankr. D. Del.), ECF No. 28-4, and the debtors and the lender jointly entered into a cash collateral budget. *Id.*, Ex. C. The pre-petition agreement provided for indemnification of the lender against, among other things, any and all claims and losses connected with the use of the proceeds of the loans and any litigation relating to the loans, except for expenses arising from an unexcused breach of the agreement or willful misconduct or gross negligence of the lender. *Id.*, Ex. A § 9.2.

Finally, in *In re Giordano's Enterprises, Inc.*, the DIP financing order entered by the court provided, among other things, that the debtors "shall indemnify and hold harmless [the lender] in accordance with the Postpetition Credit Agreement and the Prepetition Credit Agreement." *In re GEI-RP*, 11-06098 (Bankr. N.D. Ill.), ECF No. 103 at ¶ 15. The DIP financing agreement provided for an indemnification for actions relating to pre-petition indebtedness, including:

> any and all losses, claims, … and related costs and expenses, including without limitation, reasonable counsel fees and expenses, … arising out of any claim, action, suit, litigation, investigation or proceeding … which may be imposed on, incurred by, or asserted against any Indemnified Person … in any manner relating to or arising out of this Agreement, the Related Documents, or any act, event or transaction related or attendant hereto or thereto … provided, however, that such indemnity shall not apply to any such losses, claims, damages, or liabilities or related expenses determined by a court of competent jurisdiction to have arisen from the gross negligence or willful misconduct of such Indemnified Person. *Id.*, Ex. A § 7.2(r), ECF No. 9-1.

"Related Documents" included any documents executed in connection with the "Indebtedness." *Id.* at ¶ 7.1. "Indebtedness" was defined as including the debts under the pre-petition credit agreement. *Id.* Though no objection had been raised at the time that the DIP financial motion was considered, at a subsequent hearing on a related adversary proceeding, Judge Eugene R. Wedoff stated that the indemnification provision in the DIP financing

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agreement "trouble[d] him greatly," *Gesas v. Apostolou*, Adv. No. 11-02477 (Bankr. N.D. Ill.), ECF No. 23 at p. 5, and that had it been brought to his attention at the time he would have refused to enter the order, as "[t]here is simply no reason why, as a condition for getting post-petition lending, a debtor should incur an indemnification obligation for activity of the lender that had nothing to do with the post-petition lending. … " *Id.* at p. 7. Judge Wedoff's comments suggest that, at the least, courts disfavor pre-petition indemnification provisions and, perhaps, may be amenable to a challenge of such a provision.

Effect of Pre-Petition Indemnification on the Bankruptcy Estate

Pre-petition indemnification provisions are uncommon in DIP financing agreements, perhaps because such provisions can have a detrimental effect on the bankruptcy estate and its creditors, and can affect other aspects of the case as well.

For example, in *Ames*, the pre-petition indemnification substantially affected the pool of assets available to general unsecured creditors. LFD Operating, Inc. commenced an action in state court against GE Capital Corporation ("GECC"), the DIP lender, for the return of certain proceeds which LFD claimed GECC improperly received from the debtors pre-petition. *LFD Operating, Inc. v. Gen. Elec. Cap. Corp. (In re Ames Dept. Stores, Inc.)*, Case No. 06 CV 5394, 2008 WL 7542200, at *1 (S.D.N.Y. June 4, 2008). The debtors and GECC disagreed as to whether GECC was entitled to indemnification in the *LFD* litigation; ultimately, the debtors and GECC stipulated to establish an escrow account in the amount of $11.5 million for litigation costs. ECF No. 1217.

In examining whether the bankruptcy court had core jurisdiction over the litigation, the District Court for the Southern District of New York explained that the indemnification issue had a significant impact on the estate's administration, given that the substantial amount of funds to be set aside for the action called into question the estate's administrative solvency. *Id.* at *7. Thus, not only did the pre-petition indemnification provision affect the administrative solvency of the bankruptcy estate, but it also factored heavily into whether the bankruptcy court had core jurisdiction over the litigation.

In *Giordano's*, the estate funded the litigation costs of the DIP lender, Fifth Third Bank ("Fifth Third"), in a state court lawsuit filed against Fifth Third by the former principals of the debtor based upon certain alleged pre-petition misdeeds. *GEIRP*, ECF No. 1203, at ¶ 12.

Having already reimbursed more than $100,000 of Fifth Third's litigation costs, and in light of the risk of substantial additional reimbursement obligations, the Chapter 11 trustee filed a motion to settle certain claims associated with the former principals by, among other things, transferring to the former principals cash and real property having an aggregate value in excess of $2 million. *Id.* at ¶¶ 18, 20, 21, 24 and 34. In exchange, the principals agreed to release their claims against the estate and against Fifth Third with respect to the state court action, thereby relieving the estate of future indemnification obligations, except for an additional $200,000 should a non-released defendant bring Fifth Third back into the litigation. *Id.* at ¶ 24.

At the time of the settlement motion, the estate had approximately $4 million in cash, and expected to receive an additional $1.3 million from liquidation of remaining estate assets. *Id.* at ¶ 10. The Chapter 11 trustee estimated that the net assets available for unsecured creditors was approximately $3.8 million. *Id.*

The Official Committee of Unsecured Creditors filed a motion to determine the scope of the indemnification provision and an objection to the settlement motion, alleging, among other things, that the indemnification was unenforceable — in that the claims asserted against Fifth Third were based on alleged willful misconduct — and that a settlement that diverted substantial estate value to the former principals was improper on its face. The court denied the motion and overruled the objection, approving the settlement motion on grounds that notwithstanding the less than exemplary conduct of the principals, the settlement payment represented an appropriate exercise of the trustee's business judgment.

Conclusion

In light of the adverse effects that a pre-petition indemnification provision can have on a bankruptcy estate, debtors should carefully consider whether such a provision is in the best interest of the estate, and creditors and creditors' committees should pay careful attention to proposed DIP financing agreements containing such provisions.

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to renew the sublease for an additional period (for rent set at 90% to 95% of the projected rental value). In a SILO, different options apply if the lessee elects not to exercise the purchase option. The lessee must locate a third-party operator for the property and obtain nonrecourse refinancing of the lessor's outstanding debt. Payments under the third-party service contract must be sufficient to repay the nonrecourse financing. The principal tax benefits claimed by the taxpayer are deductions for head lease rent (in a LILO) or for depreciation (in a SILO) and interest on the nonrecourse debt.

Controversial Financing and Security Arrangements

The financing and security arrangements for LILOs and SILOs are particularly controversial. The controversy arises from the "economic defeasance" of the lessee's obligations and the resulting circular pattern of the movement of borrowed

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funds and of rental and purchase option payments. At the closing of the typical transaction, nearly all of the proceeds of the sale of the property (or the head lease prepayment in the case of a LILO) are deposited by the lessee in deposit accounts and/or used to purchase payment undertaking agreements from affiliates of the lenders. These deposit accounts and similar arrangements are designed to generate revenues that match in timing and amount the lessee's ongoing rent payment obligations *and the fixed-price purchase option* if the lessee elects to exercise it. The deposits are also pledged to the lessor as collateral security for the lessee's lease payment obligations. The remainder of the closing date proceeds that are not set aside in the defeasance accounts is retained by the lessee (usually around 5% to 10% of the proceeds and referred to by the IRS as the lessee's "accommodation fee").

Taxpayers have been unsuccessful defending LILO/SILO transactions. Most courts have viewed the lessee's purchase option as reasonably certain to be exercised and paid from the defeasance accounts. Under this application of the "substance over form" doctrine, the taxpayer never acquired tax ownership of the property (or head lease interest in a LILO) because it was likely to be repurchased by the lessee. Because it was almost certain that the lessee would exercise its purchase option, the taxpayer's potential for upside appreciation in asset value was capped by the option and its downside residual value risk was minimized, depriving the lessor of the benefits and burdens of ownership. Exercise was almost certain because the defeasance accounts provided a ready source of funds, making the exercise "free" to the lessee (a misleading idea because the money in those accounts belonged to and would be required to be returned to the lessee if it did not exercise the purchase option). Exercise was also highly likely because the alternatives to the purchase option were too onerous, disruptive to the lessee's operations and more economically burdensome (costly) when compared with the purchase option. Exercise was also expected because the property was essential to the lessee's business operations, which were frequently assets that provided key services to the public — like public transportation, water and electricity. *See BB&T Corp. v. United States*, 523 F.3d 461, 469 (4th Cir. 2008), *AWG Leasing Trust v. United States*, 592 F. Supp. 2d 953 (2008), *Altria Group Inc. v. United States*, 658 F.3d 276 (2d Cir. 2011), *Wells Fargo & Co. v. United States*, 641 F.3d 1319 (Fed. Cir. 2011). *See LJN's Equipment Leasing Newsletter*, March 2010 and July 2011.

A Sympathetic View

Until its reversal on appeal, *Consolidated Edison* was the only LILO/SILO case decided in favor of the taxpayer. The lower court took a much more sympathetic view of the evidence presented by the taxpayer as to the likelihood of exercise of the purchase option. Unlike in *BB&T* and *AWG*, the court did not consider the exercise of the purchase option a "virtual certainty." In contrast to the open skepticism exhibited by other courts, the judge in *Con Ed* seemed favorably impressed with the thoroughness of the appraisal and other expert reports provided as proof that alternatives to the purchase option were viable and that the purchase option was not certain to be exercised. Taking the transaction as a whole, the effect of the defeasance accounts was to reduce credit risk. It did not release the lessee from the legal obligation to pay rent and did not render the nonrecourse debt illusory. Because exercise of the purchase option was not certain, the court believed the taxpayer's investment in the residual value of the lease remained subject to market risk and should be respected.

Moreover, although the decision did not ultimately turn on economic substance/business purpose grounds, the lower court found that the taxpayer had credibly demonstrated substantial business reasons for engaging in the transaction. Con Edison is a utility, its lessee was a Dutch utility and the property in question was an electric generation plant located in the Netherlands, so the asset had logical connections to Con Edison's own operating business (in distinction to most of the other LILO/SILO investors — banks with no direct experience operating the kinds of assets leased). However, the strong business-purpose case was not enough to uphold the taxpayer victory on appeal.

On Appeal

The *Con Ed* decision was reversed on appeal on the grounds that it applied the wrong standard in evaluating whether the lessee's purchase option should be deemed exercised. The lower court had found for the taxpayer because (among other reasons) the taxpayer had demonstrated that the lessee's exercise of the purchase option was not a "virtual certainty." Two years after the *Con Ed* lower court rendered its decision, the Circuit Court for the Federal Circuit handed down its opinion affirming the government's position in *Wells Fargo*. According to the *Con Ed* appeals court, its decision in *Wells Fargo* requires that the lessor not have a "reasonable expectation" that the lessee will exercise its purchase option. The appellate court then applied this correct standard to the lower court record and concluded that while exercise may not have been a virtual certainty, the evidence clearly supported the conclusion that Con Ed reasonably expected the lessee to exercise its purchase option. The Circuit Court explained as follows:

> The Claims Court applied the wrong standard — understandably because, at the time that it rendered its decision, the Claims Court here did not have the benefit of our *Wells Fargo* decision. … While the district court found that the options at issue

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> in *Wells Fargo* were virtually certain to be exercised and we held on appeal that this finding was not clearly erroneous, we made clear that the relevant standard was reasonable likelihood. In evaluating whether the LILO Transaction in this case must be recharacterized, *Wells Fargo* requires that we assess whether a prudent investor in ConEd's position would have reasonably expected that [the lessee] would exercise the purchase option. As we stated in *Wells Fargo*:
>
> "We have never held that the likelihood of a particular outcome in a business transaction must be absolutely certain before determining whether the transaction constitutes an abuse of the tax system. *The appropriate inquiry is whether a prudent investor in the taxpayer's position would have reasonably expected that outcome.* Characterization of a tax transaction based on a highly probable outcome may be appropriate, particularly where the structure of the transaction is designed to strongly discourage alternative outcomes."
>
> 641 F.3d at 1325-26 (emphasis added). This language makes clear that a "reasonable expectation" standard, rather than a "certainty" standard, governs the recharacterization of transactions under the substance-over-form doctrine.

Note that in the very same paragraph of the quoted language from *Wells Fargo* the court enunciated yet a third standard — "highly probable." It raises the question whether the *Wells Fargo* court really meant to be as definitive about "reasonable expectation" as the *Con Ed* court concludes. Since it is the same court, it is fair to conclude that they really did mean it.

The Real Legacy

The reversal of the decision in *Con Ed* is not controversial in the context of LILO/SILO transactions. After all, these transactions had fixed-price purchase options and defeasance accounts, funded at closing with 90%-95% of sale proceeds, that ballooned to the fixed option price, and that were pledged as collateral to secure the lessee's payment obligations (including the purchase option price). The assets that were the subject of these leveraged sale-leasebacks were in most cases essential to the lessee's business operations, in many cases assets used in providing a public service. The ease with which the lessee could simply apply the defeasance proceeds to re-acquire the property made exercise attractive, even if the fixed price marginally exceeded the costs and burdens the lessee would endure should it not exercise the purchase option. It is not a long jump from "virtual certainty" to "reasonable expectation" in the context of LILO/SILO transactions.

The real legacy of this particular opinion will be the scope of its application in simpler cases where it may be more difficult to evaluate the likelihood that the lessee will exercise a purchase option. Because the case involves a LILO/SILO transaction, the temptation is to assume that the case is "limited to its facts" and its principles not applicable outside the context of LILO/SILO or similarly complicated, tax-informed leasing transactions. Because it is a LILO transaction, the *Con Ed* case is a relatively easy one to decide under the court's "reasonable expectation" standard. But what of other transactions that do not possess the features that create the fatal "ownership loop" in a LILO/SILO? Transactions with purchase options set at fair market value (rather than a fixed amount based on expected fair market value)? Transactions with no defeasance or with considerably less defeasance than LILO/SILO transactions?

Given the scope of the language used in the opinion ("a 'reasonable expectation' standard, rather than a 'certainty' standard, governs the recharacterization of transactions under the substance-over-form doctrine"), and the lack of any language limiting its application, will the IRS or a court require the lessor in any lease with a purchase option to demonstrate that it lacked a reasonable expectation that the lessee would exercise the option? If a lease has a lessee purchase option at fair market value, does this end the inquiry? If the lease has a fixed price purchase option but with little or no defeasance, does this preclude a reasonable likelihood of exercise? Can other, non-economic factors, create a reasonable expectation in the mind of a lessor that a lessee will exercise a purchase option? If so, how should a lessor go about creating a record that demonstrates that it was unaware of any such factors?

The *Con Ed* case provides some guidelines, at least in the LILO/SILO context. The court pointed to the following factors as indicating that the taxpayer failed to meet its burden of proving that the lessee's exercise of the purchase option is not reasonably likely. First, a record of a contemporaneous statement made by a *Con Ed* financial officer in response to a question from the taxpayer's accountant to the effect that the lessee's exercise was reasonably assured because the lessee had done its economic analysis on the assumption that the property would be repurchased. Second, the taxpayer's own internal financial projections did not fully evaluate the alternatives to the purchase option. Third, the appraisal obtained by the taxpayer (inexplicably) failed to mathematically demonstrate that the fixed purchase option price exceeded the costs that the lessee would incur if it elected an alternative end-of-term option, and hence that exercise of the purchase option was not economically compelled. Finally, non-economic factors, such as the asset being an essential operating asset and the lessee's financial accounting treatment, are considered along with the economic analysis.

One tax commentator has remarked about the *Con Ed* decision: "the result is what I would have expected to see in a sane world where a transaction is entered into predominantly for the tax benefits and would not have been entered into if those tax benefits did not exist." Since he has described most leveraged and single-investor equipment

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leases, he apparently does not believe equipment leasing has a place in a "sane world." Those familiar with the industry know he may be right.

Conclusion

I believe that pricing of end-of-term purchase options at then-current fair market value should go a long way toward meeting the no "reasonable expectation" standard. Unless the lessee has expressly decided to purchase the asset regardless of its actual fair market value, it would be hard to attribute any expectation about a future purchase when the amount is not fixed but unknown. Leases with fixed-price purchase options will still continue to be written after *Con Ed*. However, until questions raised by the decision are settled, it is fair to assume that lessors will look more closely at the factors that tended to demonstrate or negate reasonable expectation in *Con Ed*. Lessors are also likely to continue to require the lessee to make representations with respect to its purchase options, particularly as to non-economic factors. Under a typical tax indemnity agreement between the lessor and lessee, if the lease is successfully challenged by the IRS because the representation was untrue, the lessee is liable to the lessor for an indemnity measured by the resulting loss of tax benefits.

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But if that attorney has a staff that can handle the time-consuming detail work and is trained to use a form-based complaint — basically, fill in the blanks — all that needs to be done by the attorney is to review the filing, sign off on it, and see to it that the clerk makes sure it gets filed and served. With this kind of support staff and the attorney only involved directly when matters go to court or interaction with the obligor is necessary, the attorney can work very efficiently and cost-effectively. Of course, if there's a legal representative on the other side or when it's time for settlement, the attorney will be expected to jump in and get things resolved — as they're the only ones licensed to practice law and approve a settlement.

But regardless of how much support the attorney has, it's always important for the client to include all necessary documents and notes so the attorney has a good picture of the situation and the requisite items to proceed with collection and a lawsuit. A complete and well-organized file is especially critical for an attorney working in a small office, and it's important to have that file in the attorney's hands as soon as possible. Often, the early stages of the collection process can move forward very quickly, and a settlement can appear at any time. When the debtor first calls our attorney, he or she almost always has a "story" to tell. So it's good for the attorney to have all of the documentation in a well-organized file to be up to speed on the facts and have a way to gauge whether the debtor is bluffing or not.

And, of course, the attorney has responsibilities toward his or her client. The attorney must recognize whether he or she can service the client's needs adequately. A mutually beneficial relationship between a client and an attorney is always premised on the notion of both sides having responsibilities. At our company, we would never take the attitude of "We're the client, and we will give you a random case and let you figure it out on your own." By the same token, we expect our attorneys to be 100% focused on securing the best possible settlement for the accounts we have prepared for them.

But in the end, both sides must always realize that the most demanding part of collecting on charged-off debts is not getting the judgment, but collecting on it. Quite frankly, if these debts could be paid, chances are good they would have been long before they became charge-offs — and they certainly would not be in the process of being litigated. For any one of many reasons, the people with whom we deal will attempt to find any way imaginable to avoid paying their obligation. One of the most common tactics is that they just don't respond. In such cases, we're probably going to succeed in getting a default judgment. So once we have that, we are confronted with the real question: What are we going to do now? How, exactly, do we collect? That's where we really need the most experienced and tactically savvy attorneys — especially if they also have good investigators who are skilled at finding hidden assets.

Doing Due Diligence

Perhaps no area of building a successful relationship between a client and an attorney is more important than the commitment of the client to conducting thorough and complete due diligence on any account that is being sent to one of its attorneys. My company makes a point of doing all due-diligence research on the viability of the debt and the likelihood of collection before we send it out to one of our attorneys. Therefore, most of the files that we send have a strong likelihood of rendering some form of a settlement result. Of course, some of the obligors may file for bankruptcy or the claim may go stale before judgment, but, at least on its face, the greater percentage of our files yield some sort of collection result for our attorneys and for us.

So, before even considering sending an account to an attorney, the client must confirm that it has a reasonable expectation of being collectable. Beyond common professional courtesy, this is crucial toward cultivating a strong relationship with the attorney. There's absolutely no need to waste the attorney's time and your court costs if the matter is not likely to render a return to both parties.

In short, one proven way to build a strong relationship is to not stick your attorneys with weak, flawed, uncollectable accounts, and there's

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Benefits of Trust

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no better time to make this determination than before they leave your office. Our attorneys tell me they appreciate that we send them collectable files. Other clients, they tell me, will send them everything and anything they have without screening it for collectability or merit or even, in some cases, bankruptcy of the obligor. We investigate the obligor to gain an understanding of what assets, if any, are collectable. Sometimes, we discover the debtor is dire, in which case we're not going to collect anything — but just have our attorney spinning his wheels and wasting time and money. Neither of us benefits then.

The Fine Balance of Contingency Fees

When discussing fee arrangements, there has to be something that's comfortable to both sides. The client has to understand his fee structure — whether hourly or contingent — and has to be careful to not short-change the attorney. The simple truth is if the attorney's fee is too low, you're going to be on the bottom of his or her list when other matters, usually involving higher compensation, need attention. On the other hand, as the client, you can't give away the accounts you purchased and the time and effort you've invested in performing your due diligence on them. To stay in business, you must earn a return on some portion of the settlement proceeds from the accounts you bought and distributed to your attorneys. So there has to be a fee structure that works for both sides to get what's fair.

Keeping the Relationship Healthy

Maintaining a mutually beneficial relationship, then, often comes down to being proactive about ways to improve it — for both sides.

The attorneys always need responsiveness from the client — especially if they're just working for a contingency fee out of what they collect. If they have litigated successfully to the point of having an obligor who's eager and ready to settle but the client is either not getting back to them or is being irrational as to what it wants or expects out of the case, there's not much the attorney can do. If the client doesn't get back to the attorney at all, or does respond but with an irrational or uninformed settlement offer, the attorney can lose the opportunity to settle altogether. So it's critically important for attorneys to do their own due diligence of their potential clients before they take on their accounts.

For the client, many proactive steps can be taken to earn the attorney's appreciation and loyalty. Beyond the need for thorough due diligence and packaging of every account that is sent to the attorney, a host of other courtesies can ensure that the attorney values you as a client not just because you give business but because of the quality of the business you send and your responsiveness to his or her needs in settling it.

The first simple rule of thumb is to always pay the attorney promptly. Pay any fees and court costs immediately upon receipt of the bill. This sounds simple, but many clients are slow in paying their bills — which is no way to show you really value your attorney as a partner in your efforts. Prompt payment shows that you are on top of their work and value it.

The second rule is to always return e-mails and phone calls promptly. Beyond common courtesy, you're keeping the lines of communication open and allowing your attorney to remain focused on settling the account. Help the attorney with any questions he or she may have; they may need you to answer discovery, request a date for a hearing, or require settlement authority on your behalf. By being proactive and responsive to these needs as they arise, you are reinforcing the partnership structure. And remember always that just because you are the client does not mean you should act like one. Always look for ways to assist in positive outcomes.

Of course, the attorney must do his or her part to help build a strong relationship. It's often as simple as reciprocating with the common professional courtesies that are being extended by the client. Always return client e-mails and phone calls promptly. Set aside a regular time to update the client, at least monthly, on the status of any litigation or collection matter. If the attorney gets a settlement, call the client and gloat — that's right: gloat. After all, it's a cause for mutual celebration. Don't be afraid to let the client know that you are proud of having done a good job, would like to have the opportunity to do a similarly good job on additional work in the future, and you want them to know it. Let them know they did a good job in sending you a well-vetted and organized account.

In conclusion, I have found the best relationships with my attorneys have grown out of a mutual recognition of what each of us needs to achieve a common goal: the best possible return on the charged-off debt they have been sent to settle. In our relationships, I've had attorneys say, "I love you as a client because you pay your bills, you get me my costs immediately, you're responsive with answers when I need them, and you send me collectable accounts." This tells me my attorney understands what we're looking for, and is in synch with my goals and objectives. Building this sort of mutually beneficial relationship is the best way to ensure rewards for both of us.

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