

Good Business, Bad Operator

Johnny Two-Time is a businessman and entrepreneur who, as of two years ago, owned 100% of Strawberry, which is a start-up tech company that manufactures and sells its own products, including but not limited to cell phones, tablets, and computers.

At its inception, in order to fund initial purchase orders for its products, Strawberry incurred debt from ABC Bank, N.A., and Two-Time signed a personal guaranty. In order to obtain the debt, Strawberry, through Mr. Two-Time, misrepresented its assets and liabilities. Mr. Two-Time also made misrepresentations on his personal financial statement he provided to show he was a worthy guarantor for Strawberry's business loan.

Although Strawberry's sales have been growing substantially over the past couple of years, Mr. Two-Time has diverted substantial funds to himself to fund his other ongoing businesses, including his multi-level marketing startup – he is after all an entrepreneur who takes pride in having many streams of passive income.

For that reason, Strawberry has incurred more debt in the form of merchant cash advances from "internet" lenders, who also required personal guaranties from Mr. Two-Time. Because the merchant cash advance lenders pull money daily from Strawberry's accounts and charge extremely high fees, it has become impossible for Strawberry to meet its ongoing expenses, despite increasing demand for its products.

Mr. Two-Time, desperate for cash, decided to sell part of his 100% ownership interest in Strawberry. He successfully sold 49% of the business to Mr. Blue Sky, who makes a living investing in start-up businesses with strong goodwill and growing sales numbers. Mr. Blue Sky asked for and was provided many financial documents from Strawberry and Mr. Two-Time as part of his due diligence in determining whether to invest in Strawberry. The financial statements and other documents provided by Strawberry to Mr. Blue Sky were not accurate, as the financials showed net income that was much higher than reality.

Two creditors have filed a lawsuit against Strawberry and Mr. Two-Time for breach of contract and fraud. Mr. Two-Time has called bankruptcy lawyer to set up a consultation to discuss whether he and/or Strawberry should file bankruptcy.

Questions:

- 1) Can the same lawyer represent Strawberry and Two-Time in their bankruptcy cases? What would be some reasons that a lawyer could not? Either way, what type of bankruptcy might be best for both and why?
- 2) Are the "internet" lenders subject to the automatic stay since their agreement states they "purchased" future receivables? What defenses does Strawberry have if it files a Chapter 11 case?
- 3) What are Mr. Blue Sky's options/remedies in Strawberry and Two-Time's bankruptcies, if in fact they both file?