

# Dealing With Crisis: Gibbons Teams Up With NachmanHaysBrownstein

The Business Advisor

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**O**n January 27, 2009, the FBI and several other federal law enforcement agencies executed a search warrant at the Pine Brook, N.J. offices of U.S. Mortgage and its affiliate CU National, licensed mortgage brokers. Employees were instructed to step away from their desks and telephones, and gather in the center of the room while federal agents removed computers and files. The employees were quite afraid and some wept openly—was there a bomb in the building?

It soon came to light that the companies' president and sole director, Michael McGrath, Jr. had allegedly been orchestrating a massive fraud against Fannie Mae and credit unions around the country by double-selling mortgages. The president himself was no longer on the premises, having undergone a similar search of his residence. His wife, also a company officer, had departed as well. The companies' Senior Vice President and General Counsel, who had had no involvement with the alleged bad acts, was the only senior officer left, and he had had no prior experience with a troubled business, let alone one in this situation. The word was already out, and the companies' ability to process and close mortgages had evaporated with its lines of credit.

But what about the over 1,000 mortgage loans that were in the "pipeline": loans which had already been committed to with interest rates locked-in? Eager families had paid deposits to sellers and were ready to close and move into their new homes, but could instead lose their deposits if the mortgage funds didn't arrive on the closing date. The storm may have ended with the departure of law enforcement authorities, but, as with Hurricane Katrina, the damage was far from over.

Within days and working closely with law enforcement, a multi-disciplinary team of Gibbons attorneys -- Directors Karen Giannelli (Financial Restructuring & Creditors Rights), Larry Goldman (Corporate) and Bob Hanna (Criminal Defense) -- solved the corporate governance conundrum caused by the abrupt departure of the companies' president and sole director and called in turnaround professionals from NachmanHaysBrownstein, Inc. (NHB), a leading turnaround and crisis management firm. A caseteam led by NHB Principal Howard Brod Brownstein, a Certified Turnaround Professional (CTP) arrived almost immediately. The NHB team quickly stepped in to provide hands-on management, and the Gibbons team worked to satisfy corporate governance requirements so that the former president and sole director would resign, the Senior Vice President-General Counsel would become the sole director, and Mr. Brownstein would become the companies' Chief Restructuring Officer. As Chair of the New Jersey Chapter of Turnaround Management Association and a 28-year veteran of Gibbons' bankruptcy and insolvency practice, Ms. Giannelli appreciated the impending crisis and the emergent need to shore up the client's management team with a turnaround professional. Through her professional relationship with Mr. Brownstein, she was able to garner that valuable assistance in short order.

NHB's first crisis management priority was to get control of the companies' cash. Since the companies' CFO was then under suspicion for involvement but was nonetheless needed to deal with the deteriorating situation, NHB removed him as a signatory on bank accounts and installed one of its experienced professionals as "shadow CFO"

and joint signatory with the Senior Vice President-General Counsel. The companies operated in 33 states, including through 26 branches, and these were summarily closed and the former branch employees permitted to seek alternative financing for their loan files. The NHB caseteam, together with the companies' managers, quickly contacted some two dozen credit unions that had "pipeline" loans, and arranged to return the loan files to them so that they could fund the mortgages themselves or find alternative financing. Fortunately, the result has been that, so far as anyone is aware, every borrower found alternative financing and not a single borrower default occurred. Gibbons and NHB have stated that the Senior Vice President-General Counsel is the real hero of this case, since he could easily have left, which would likely have forced a much worse recovery for the creditors.

Although NHB had sought to avoid a bankruptcy filing, preferring to pursue a consensual wind-down, a recalcitrant telecom provider forced a Chapter 11 filing on February 23, 2009 in U.S. Bankruptcy Court in Newark. Due to a potential conflict, Gibbons elected to limit its retention to special criminal law counsel, with partner Bob Hanna handling all matters dealing with the federal criminal investigation and the relevant federal agencies.

Gibbons' Bob Hanna, a former federal prosecutor in the District of New Jersey, worked with the federal law enforcement agencies and NHB's team to coordinate efforts to investigate the alleged fraud perpetrated by Michael McGrath, Jr. NHB's thorough forensic investigation resulted in a determination that the fraud perpetrated by Mr. McGrath, Jr. amounted to over \$138 million. On June 11, 2009, less than

5 months after execution of the search warrants, Mr. McGrath, Jr. entered guilty pleas to charges of mail fraud, wire fraud and money laundering. Left for another day was a determination of who would be considered the rightful owners of the double-sold mortgages: Fannie Mae, or the financial institutions which had originated the mortgage transactions. Mr. Hanna, a 16-year veteran of the U.S. Attorney's office in Newark office and former chief of its Securities & Health Care Fraud Unit, knows its personnel and procedures well and continues to coordinate efforts to cooperate with law enforcement.

NHB is no stranger to bankruptcy proceedings, having handled over hundreds of such engagements for debtors and creditors in

New Jersey, Delaware and elsewhere, so the rapid wind-down process continued unabated after the filing. One of the Debtors' main assets was the right to service some 2,100 loans on behalf of approximately 100 credit unions, some of whom were among the ones defrauded by Mr. McGrath, Jr. NHB followed standard guidelines for creating a sale of the loan servicing rights pursuant to §363 of the Bankruptcy Code, and sales were consummated in early May 2009, netting the bankruptcy estate over \$1 million.

Within a few short months since arriving on the scene, NHB has filed a Liquidating Plan with the Bankruptcy Court, and final wind-down and disbursement matters will be turned over to a Liquidating Trustee by fall 2009.



\*Howard Brod Brownstein, CTP is a Principal at NachmanHaysBrownstein, Inc., a leading turnaround and crisis management firm.