



Bankruptcy 101: In-house counsel

J. Machir Stull, Cantey Hanger LLP

The Bankruptcy Code

- ▶ Title 11 of the United States Code (1978)
- ▶ **Chapter 1** - General provisions, like definitions
- ▶ **Chapter 3** - Case administration, like how cases are filed, how professionals hired and compensated, meetings of creditors (341), and the automatic stay
- ▶ **Chapter 5** - Creditors, debtors and the estate, like proofs of claim, property of the estate, and avoidance actions (preferences and fraudulent transfers)
- ▶ **Chapter 7** - Liquidation
- ▶ **Chapter 11** - Reorganization
- ▶ **Chapter 13** - Individual
- ▶ Other chapters include **Chapter 9** (municipalities), **Chapter 12** (farms), and **Chapter 15** (cross-border)

Bankruptcy Authority

- ▶ First, Bankruptcy Code
- ▶ Second, Bankruptcy Rules
- ▶ Third, Local Bankruptcy Rules

“The bankruptcy court is essentially a court of equity and does not read “statutory words with the ease of a computer. There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction.”

In re Williams, 7 B.R. 234, 236 (Bankr. M.D. Ga. 1980)

“The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”

11 U.S.C. § 105(a)

Major Players

- ▶ **Debtor** - Section 109 states who can be a debtor (generally excludes railroads and insurance companies).
 - ▶ Sometimes called “Debtor-in-Possession” or the “DIP”.
- ▶ **Chief Restructuring Officer** - Creditors lost confidence in management or management conflicted. Objective guidance.
- ▶ **US Trustee** - The United States Trustee Program is the component of the Department of Justice responsible for overseeing the administration of bankruptcy cases and private trustees. Has broad administrative, regulatory, and litigation/enforcement authorities whose mission is to promote the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders.

Major Players (continued)

- ▶ **DIP Lender** - Debtor-in-possession financing (DIP financing) is a special kind of financing meant for companies that are financially distressed and in bankruptcy.
 - ▶ Debtor and Lender agree to a "DIP budget," which includes a rolling 13-week budget.
- ▶ **Committees** - “[A]s soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors or of equity security holders as the United States trustee deems appropriate.” 11 U.S.C. § 1102.
 - ▶ Creditors Committee
 - ▶ Equity Committee (publicly traded company)
 - ▶ Ad Hoc Committee (landlords)

Protect the interests of the group they represent, not their individual interest. *See, e.g., In re Nat'l Liquidators, Inc.*, 171 B.R. 819, 826 (Bankr. S.D. Ohio 1994).

Major Players Example

- ▶ Debtor prepares for Chapter 11 bankruptcy, including by finding DIP financing
- ▶ Debtor files bankruptcy
- ▶ US Trustee appoints Creditors Committee
- ▶ Creditors Committee objects to DIP Financing, based upon high interest rates and unreasonable fees. Identifies alternative DIP Lenders
- ▶ Original DIP Lender lowers rates / fees, and is approved by Court.

Fundamental concepts

- ▶ **Automatic stay** - An injunction (“breathing spell”) that automatically stops lawsuits, foreclosure, garnishments and all collection activity against the debtor the moment a bankruptcy petition is filed. 11 U.S.C. § 362.
- ▶ **341 meeting** - A meeting of creditors at which the debtor is questioned under oath by creditors, a trustee, examiner, or the United States trustee about his/her financial affairs. 11 U.S.C. § 341.
- ▶ **Property of the estate** - All legal or equitable interests of the debtor in property, both real and personal, at the time of the bankruptcy filing. The estate includes all property in which the debtor has an interest, even if it is owned or held by another person. 11 U.S.C. § 541.
- ▶ **Executory contract** - Generally includes contracts or leases under which both parties to the agreement have duties remaining to be performed. If a contract or lease is executory, a debtor may assume it or reject it. 11 U.S.C. § 365.

Fundamental concepts (continued)

- ▶ **363 sales** - Sale of the debtor's assets, ranging from sale of office furniture by Chapter 7 trustee to sale of entire business of Chapter 11 debtor. "Free and clear" benefit. 11 U.S.C. § 363.
- ▶ **Preference** - A debt payment made to a creditor in the 90-day period before a debtor files bankruptcy (or within one year if the creditor was an insider) that gives the creditor more than the creditor would receive in the debtor's chapter 7 case. 11 U.S.C. § 547.
- ▶ **Fraudulent transfer** - A transfer of a debtor's property made with intent to defraud or for which the debtor receives less than the transferred property's value. 11 U.S.C. § 548.
- ▶ **Discharge** - A release of a debtor from personal liability for certain dischargeable debts.

Chapter 11 Concepts

- ▶ **Disclosure Statement** - A document prepared by the chapter 11 debtor or other plan proponent that is designed to provide "adequate information" to creditors to evaluate the chapter 11 plan. 11 U.S.C. § 1125.
- ▶ **Plan** - A debtor's detailed description of how the debtor proposes to pay creditors' claims over a fixed period of time. 11 U.S.C. § 1123.
- ▶ **Cram Down** - A plan may be approved despite the rejection of creditors if the plan is deemed to be fair and equitable and not unfairly discriminatory. Need at least one impaired accepting class. 11 U.S.C. § 1129(b).
- ▶ **Absolute Priority Rule** - Bars any class of creditors from receiving any distribution unless all claims of each senior class are paid in full.
 - ▶ All secured creditors must be paid in full before unsecured creditors may be paid anything, and all unsecured creditors must be paid in full before holders of equity receive anything.

Vendor Issues and Strategies

- ▶ **Automatic Stay** - Can include demanding repayment, trying to collect money owed, taking or exercising control of debtor's property, terminating contractual rights, and setting off amounts owed. Contempt of court and damages.
- ▶ **Continuing to do Business** - In general, if the bankrupt customer is a Chapter 11 debtor, it is legally permitted to pay for post-petition (post-bankruptcy filing) purchases of goods and services in the ordinary course of business. Such amounts are generally accorded administrative claim status, with priority over unsecured and certain other claims, and the debtor is authorized to pay them currently.
 - ▶ The standard for allowance of administrative claims requires proof of the necessity and the value to the estate of the goods or services.
 - ▶ Always ask if given “administrative priority” and in “ordinary course”.

Vendor Issues and Strategies (continued)

- ▶ Regular vendor?
- ▶ Contract counterparty?
- ▶ Continue doing work post-petition?
- ▶ Unpaid invoice?
- ▶ Recently shipped goods?
- ▶ Party in lawsuit?
- ▶ Did I potentially receive a preference or fraudulent transfer?

Vendor Issues and Strategies (continued)

- ▶ Regular vendor?
 - ▶ Will the Debtor use your services post-petition?
 - ▶ If so, will there be a critical vendor list? **Always ask.**
 - ▶ Vendors ordinarily will be GUC for pre-petition debt (i.e., \$0).
 - ▶ Vendors can threaten to stop doing business with a debtor post-petition.
 - ▶ Creation of “Critical Vendor List”, where pre-petition claim is paid in full (or some other negotiated amount) in exchange for ongoing business and agreed upon terms.
- ▶ Contract counterparty?
 - ▶ Will the Debtor assume or reject your contract? **Always ask.**
 - ▶ To assume, must cure all defaults (or some other negotiated amount).
 - ▶ If rejected, damages paid as GUC.
 - ▶ Move for relief from stay to terminate contract.

Vendor Issues and Strategies (continued)

- ▶ Shipped Goods?
 - ▶ **Reclamation rights** - The goods must have been sold in the “ordinary course” of the vendor’s business and the debtor must have received the goods while insolvent. Also, the reclamation demand must be in writing and made within 45 days of the receipt of the goods by the customer (now the debtor in bankruptcy) or within 20 days of the bankruptcy filing.
 - ▶ Hire counsel. File with Court and send to Debtor.
 - ▶ Often difficult, because of Debtor’s lender (floating lien). Also limited to goods in Debtor’s possession, which can be hard to prove.
 - ▶ **503(b)(9) claim** - Safety net if cannot recover on reclamation rights.
 - ▶ Provides creditors with an administrative expense claim for goods (not services) that a debtor receives in the 20 days before bankruptcy, often resulting in dollar-for-dollar recovery.

Vendor Issues and Strategies (continued)

- ▶ Party in a Lawsuit?
 - ▶ Automatic Stay. Remove to bankruptcy court or lift the automatic stay.
- ▶ Recipient of preference or fraudulent transfer?
 - ▶ Don't overthink it, just get paid.
- ▶ Other basic steps:
 - ▶ **Attend 341 meeting.** Mini-deposition, which is recorded and under oath. Intended to be wide open.
 - ▶ **File Proof of Claim.** Prima facie evidence of debt, if includes proper information (debtor name; identification of creditor; claim as of petition date; basis for claim; type of claim). Always attach support documentation, with redactions (if necessary).
 - ▶ Claim based on writing, a copy of the writing must be included. Rule 3001(c).

Vendor Issues and Strategies (continued)

- ▶ Do I want to serve on the Creditors Committee?
 - ▶ Typically, 5-7 members.
 - ▶ Typically, will not be selected unless have major (top 20) claim.
 - ▶ Opportunity to shape case, but requires a lot of work.
 - ▶ Fiduciary to all unsecured creditors.
 - ▶ Receive insider information.
 - ▶ Hire counsel, paid for by debtor.
 - ▶ Often (not always), it is not worth it for a client.

CANTEY HANGER LLP

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