

Bankruptcy Basics

June 9, 2009

Brooks Hamilton

Haynes and Boone, LLP

www.haynesboone.com

Purposes of bankruptcy

- Mechanism to allow person or company that cannot pay creditors to resolve debts through division of property
- “Fresh Start” for the Debtor
- Equality among similar creditors

The U.S. Bankruptcy System

- Bankruptcy Code
 - Uniform system of bankruptcy laws known as the Bankruptcy Code (Title 11 of the U.S. Code).
 - The Bankruptcy Code is divided into chapters. Each chapter governs a different aspect of a bankruptcy case.

The U.S. Bankruptcy System

- Bankruptcy Courts
 - System of specialized Bankruptcy Courts that adjudicate bankruptcy proceedings.
 - District Courts have jurisdiction, but refer cases to the Bankruptcy Courts.
 - Appeals are to the District Court or Bankruptcy Appellate Panel ("BAP"), then to the Circuit Court of Appeals.

Commencement of a Case

- Voluntary and Involuntary Petitions
- Chapter 7 – Liquidation
- Chapter 9 – Municipality Reorganization
- Chapter 11 – Business Reorganization
- Chapter 12 – Farmer Reorganization
- Chapter 13 – Individual Reorganization
- Chapter 15 – Cross-Border Cases

Where is a bankruptcy case filed?

District in which the Debtor's domicile, residence, principal place of business, or principal assets have been located for 180 days

OR

District in which the bankruptcy case of the Debtor's affiliate, general partner, or partnership is pending.

How do you find a particular bankruptcy case?

Popular Venues: SDNY, Delaware

Search the U.S. Party/Case Index:

<http://pacer.uspci.uscourts.gov>

(does not include Courts of Appeal for the
Second, Eleventh, and Federal Circuits)

Players

**Bankruptcy
Court**

**US Trustee's
Office**

Debtor

**Unsecured
Creditors
Committee**

**Secured
Creditors**

Attorneys

Accountants

Financial Advisors

Stockholders

**Other
Creditors**

**Governmental
Agencies**

**Organized
Labor**

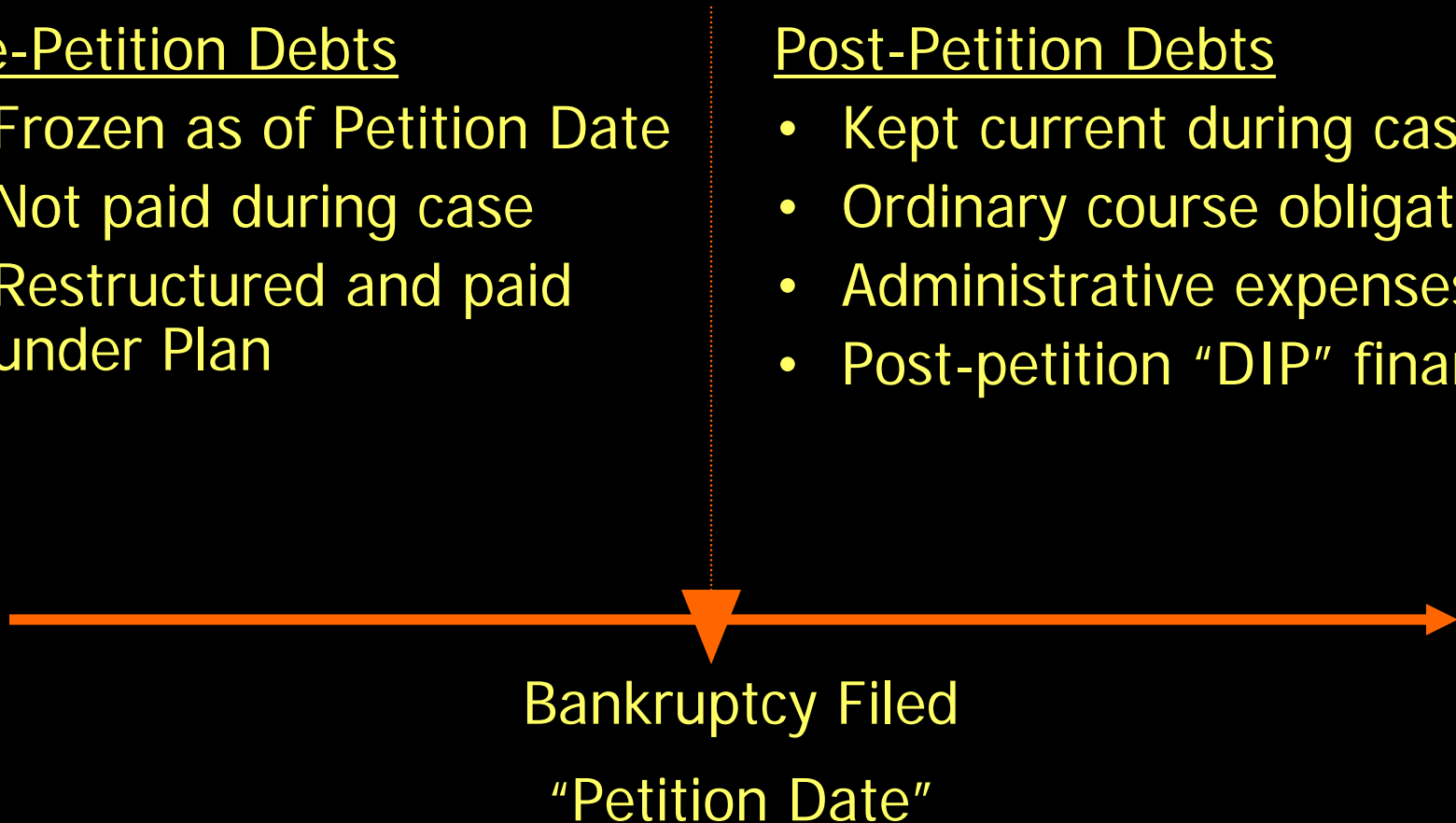
Debts and the Petition Date

Pre-Petition Debts

- Frozen as of Petition Date
- Not paid during case
- Restructured and paid under Plan

Post-Petition Debts

- Kept current during case
- Ordinary course obligations
- Administrative expenses
- Post-petition "DIP" financing



Types and Priority of Debt

- 1) Secured Debt
- 2) Priority Unsecured Debt
 - Administrative Expenses
 - Pre-petition Employee Wages
 - Pre-petition Taxes
 - Section 503(b)(9) Claims
- 3) Unsecured Debt
- 4) Subordinated Debt
- 5) Equity (Stockholders)

Estate

- All of the Debtor's interest In property as of the Petition Date
- Some exceptions (Trust Funds)
- Exemptions
- Important in determining assets available to creditors

Chapter 7

- Liquidation
- Chapter 7 Trustee
 - Powers of Judgment Lien Creditor
 - Avoid Unperfected Security Interests
 - Pursue Litigation
- Goal: Gather Non-Exempt Assets and Distribute According to Priorities

Chapter 7

- Discharge for individuals
 - With certain exceptions (see Section 523)
- No discharge for corporations

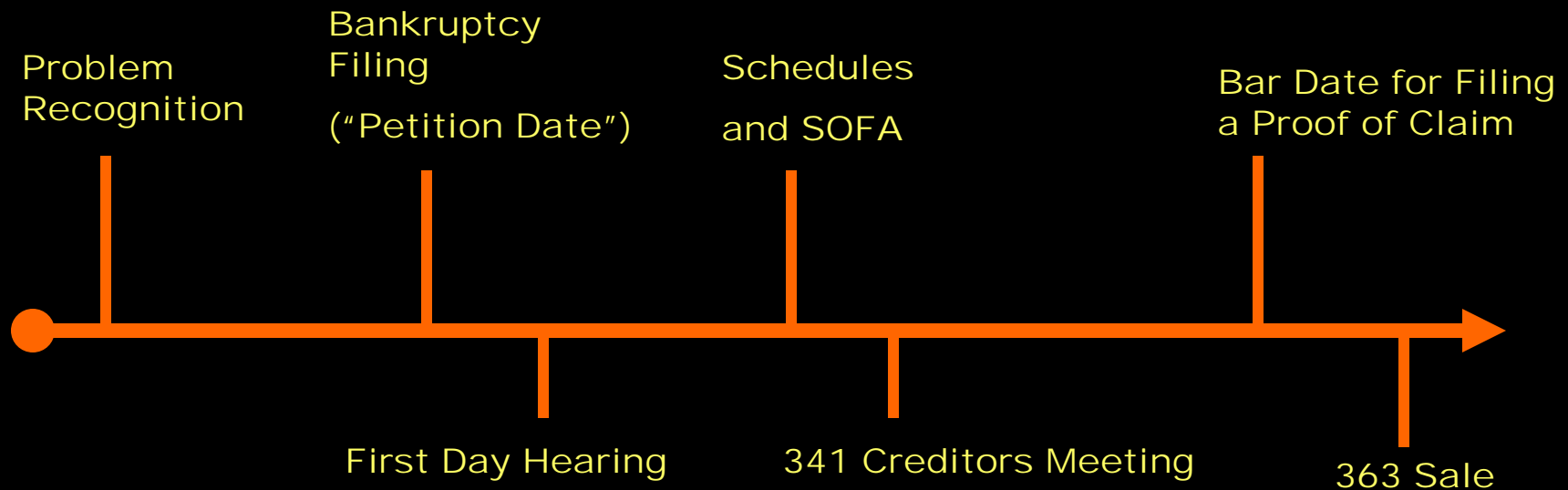
Why file Chapter 11?

- Delay exercise of creditor remedies
- Restructure debts
- Eliminate burdensome contracts
- Implement restructure with less than 100% creditor cooperation
- Implement M&A strategy

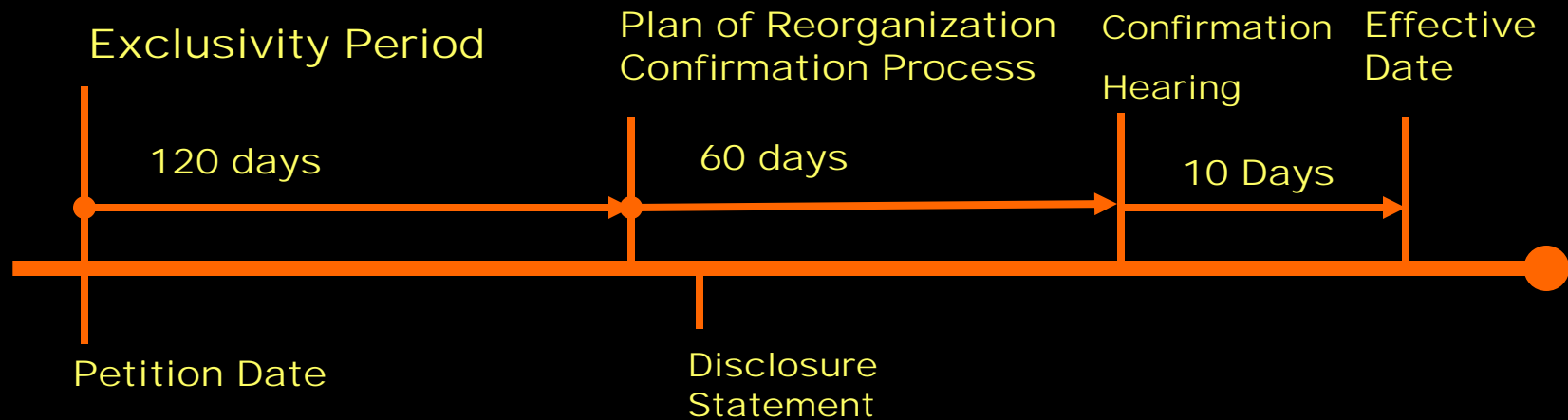
Chapter 11

- “Debtor-in-Possession” stays in control, unless a Chapter 11 Trustee is appointed
- Fiduciary duty to maximize estate for creditors
- Ordinary course transactions permitted
- Most other transactions require court approval

Typical Chapter 11 Timeline



Typical Chapter 11 Timeline



Petition, Schedules, SOFA

- Schedules of Assets and Liabilities
- Statement of Financial Affairs ("SOFA")
- Great sources of information about the Debtor
- Available on Court's docket – not served

Petition

- Estimated number of creditors
- Estimated total assets
- Estimated total liabilities
- Nature of Debtor's business
- List of 20 largest unsecured creditors usually attached

Schedules

- Schedule A – Real Property
- Schedule B – Personal Property
- Schedule C – Exempt Property
- Schedule D – Secured Creditors
- Schedule E – Unsecured Priority Creditors
- Schedule F – Unsecured Non-Priority Creditors
- Schedule G – Executory Contracts / Unexpired Leases
- Schedule H – Codebtors
- Schedule I – Current Income (individuals only)
- Schedule J – Current Expenditures (individuals only)

SOFA

- Lawsuits during past year
- Property that was seized/repossessed during past year
- Environmental sites, proceedings
- Current and former officers and directors
- Stockholders who control over 5%
- Debtor's accountants / bookkeepers
- Debtor's tax consolidation group

Participating in a Bankruptcy Case

- In large cases, court may establish a limited service list
- But any party-in-interest can file a "Notice of Appearance" requesting service of all pleadings
- If firm represents multiple creditors in a Chapter 11, file a Rule 2019 Statement

Participating in a Bankruptcy Case

- Electronic filing is mandatory
- Court docket (PACER - 8¢ per page)
- Claims agent or Debtor's website (free)
- Monthly Operating Reports

Automatic Stay

- Effective as soon as the bankruptcy petition is filed.
- Can't take any act to collect a debt or exercise control over property of the Debtor:
 - Payment demands
 - Lawsuits
 - Foreclosure
 - Setoffs
 - Termination of a contract or lease



Automatic Stay

- Can file a motion requesting relief from the stay
 - For cause
 - If property isn't necessary for a successful reorganization and Debtor lacks equity

"First Day" Hearing

- Usually within the first week after the Petition Date
- Things happen quickly!
- DIP financing, cash collateral, employee wages, critical vendors, payment of estate professionals

Cash Collateral

- Cash generated by the Debtor's sale or use of property that is subject to a security interest.
- Debtor can't use it without the secured creditor's permission or a court order.

DIP Financing

- If use of cash collateral is insufficient to meet the Debtor's operating needs, the Debtor may obtain a loan to finance its reorganization.
- The business of making loans to companies in bankruptcy is known as Debtor-in-Possession ("DIP") Financing.
- DIP Lender gets a priming lien and wields a lot of influence in the case.

341 Creditors' Meeting

- Bankruptcy Code requires the Debtor to give testimony and answer questions on the record about the reasons for filing bankruptcy
- Questions about the Schedules and SOFA
- Presided over by UST in chapter 11 and trustee in chapter 7
- Anyone can attend
- Chance to take "free discovery" of Debtor

Proofs of Claim

- What is a Proof of Claim?
- Where do you find one?
- Should you file one?
- Where do you file one?
- When?

UNITED STATES BANKRUPTCY COURT _____ DISTRICT OF _____		PROOF OF CLAIM
Name of Debtor: _____		Case Number: _____
NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A request for payment of an administrative expense may be filed pursuant to 11 U.S.C. § 503.		
Name of Creditor (the person or other entity to whom the debtor owes money or property): _____		<input type="checkbox"/> Check this box to indicate that this claim amends a previously filed claim. Court Claim Number: _____ (if known) Filed on: _____
Name and address where notices should be sent: _____ Telephone number: _____		
Name and address where payment should be sent (if different from above): _____ Telephone number: _____		<input type="checkbox"/> Check this box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars. <input type="checkbox"/> Check this box if you are the debtor or trustee in this case.
1. Amount of Claim as of Date Case Filed: \$ _____ If all or part of your claim is secured, complete item 4 below; however, if all of your claim is unsecured, do not complete item 4. If all or part of your claim is entitled to priority, complete item 5. <input type="checkbox"/> Check this box if claim includes interest or other charges in addition to the principal amount of claim. Attach itemized statement of interest or charges.		5. Amount of Claim Entitled to Priority under 11 U.S.C. §507(a). If any portion of your claim falls in one of the following categories, check the box and state the amount. Specify the priority of the claim. <input type="checkbox"/> Domestic support obligations under 11 U.S.C. §507(a)(1)(A) or (a)(1)(B). <input type="checkbox"/> Wages, salaries, or commissions (up to \$10,950*) earned within 180 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier - 11 U.S.C. §507 (a)(4). <input type="checkbox"/> Contributions to an employee benefit plan - 11 U.S.C. §507 (a)(5). <input type="checkbox"/> Up to \$2,425* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use - 11 U.S.C. §507 (a)(7). <input type="checkbox"/> Taxes or penalties owed to governmental units - 11 U.S.C. §507 (a)(8). <input type="checkbox"/> Other - Specify applicable paragraph of 11 U.S.C. §507 (a)(____). Amount entitled to priority: \$ _____ <small>*Amounts are subject to adjustment on 4/1/10 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment.</small>
2. Basis for Claim: _____ (See instruction #2 on reverse side.)		
3. Last four digits of any number by which creditor identifies debtor: _____ 3a. Debtor may have scheduled account as: _____ (See instruction #3a on reverse side.)		
4. Secured Claim (See instruction #4 on reverse side.) Check the appropriate box if your claim is secured by a lien on property or a right of setoff and provide the requested information. Nature of property or right of setoff: <input type="checkbox"/> Real Estate <input type="checkbox"/> Motor Vehicle <input type="checkbox"/> Other Describe: _____ Value of Property: \$ _____ Annual Interest Rate _____ % Amount of arrearage and other charges as of time case filed included in secured claim, if any: \$ _____ Basis for perfection: _____ Amount of Secured Claim: \$ _____ Amount Unsecured: \$ _____		
6. Credits: The amount of all payments on this claim has been credited for the purpose of making this proof of claim.		
7. Documents: Attach redacted copies of any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, judgments, mortgages, and security agreements. You may also attach a summary. Attach redacted copies of documents providing evidence of perfection of a security interest. You may also attach a summary. (See instruction 7 and definition of "redacted" on reverse side.) DO NOT SEND ORIGINAL DOCUMENTS. ATTACHED DOCUMENTS MAY BE DESTROYED AFTER SCANNING. If the documents are not available, please explain: _____		
Date: _____	Signature: The person filing this claim must sign it. Sign and print name and title, if any, of the creditor or other person authorized to file this claim and state address and telephone number if different from the notice address above. Attach copy of power of attorney, if any.	
	FOR COURT USE ONLY	

Section 503(b)(9) Claims

- Seller gets an administrative expense priority claim for the value of goods the Debtor received within 20 days before the Petition Date.
- Might not be paid until confirmation.
- Bar date?

Section 546 Reclamation Claims

- UCC recognizes seller's right to reclaim goods sold to an insolvent buyer
- Bankruptcy Code expands the UCC's 20 day deadline to 45 days
- Send a demand letter to the Debtor
- Seller can still assert a 503(b)(9) claim if it misses this deadline

Executory Contracts and Unexpired Leases

- “Executory” means obligations remain on both sides
- Rejection = pre-petition claim for damages
- Assumption = all defaults cured (including payment of pre-petition claim in full)
- Assignment does not require non-debtor’s consent, but the assignee must demonstrate “adequate assurance” that it can perform under the contract

Executory Contracts and Unexpired Leases

- Deadline for Debtor to assume/reject:
 - Chapter 7 - 60 days after Petition Date
 - Chapter 11 - Before Plan confirmation
- Both parties may have to perform during “limbo period” while Debtor decides
- Can file a motion to compel Debtor to assume or reject

Executory Contracts and Unexpired Leases

- Some restrictions on non-residential real property leases:
 - Debtor must assume or reject the lease before earlier of 120 days from the Petition Date OR the date of the confirmation order
 - Extension is available for 90 additional days; after that, need landlord's consent

Section 363 Sales

- Debtor can sell property during the case.
- In some circumstances, court may allow the Debtor to sell all or substantially all of its assets through Section 363 instead of a Plan of Reorganization (e.g., Chrysler)

Typical Sale Process

- Marketing of Property
- Negotiation of Purchase Agreement with Stalking Horse Bidder
- Approval of Bid Procedures (Breakup Fee)
- Auction
- No Collusive Bidding
- Sale Free and Clear of Liens
- Limitations on "Sub Rosa" Plans

Avoidance Actions

- Goal is to prevent preferential treatment of certain creditors and recover improperly transferred assets
- Effect is to return assets to the estate to be distributed among all creditors
- Take place in an “Adversary Proceeding” – a lawsuit within the bankruptcy case

Preferences (Elements)

- Transfer of the Debtor's property or interest in property (e.g., payment)
- To or for the benefit of a creditor
- On account of an antecedent debt
- Within 90 days before the Petition Date
- Made when the Debtor is insolvent (presumed)
- Allows the creditor to recover more than it would in an imaginary Chapter 7 liquidation (i.e., creditor is not fully secured)

Preference Defenses

- Contemporaneous Exchange for New Value
- Ordinary Course Of Business
- Subsequent New Value

Fraudulent Transfers

- Actual Fraud: Transfer undertaken with actual intent to defraud creditors
- OR
- Constructive Fraud: Where the Debtor receives less than "reasonably equivalent value" in exchange for the transfer and Debtor is insolvent, has unreasonably small capital, or believes it will be unable to pay debts as they become due

Plan of Reorganization

- A Plan of Reorganization is a proposal to creditors about how the Debtor will pay them.
- Creditors vote for or against the Plan.
- If approved by the court ("confirmed"), the Plan becomes a legally binding agreement between the Debtor and its creditors.
- Pre Packs/Lockup Agreements

Confirmation Process

- Exclusivity Period: Only Debtor can file a Plan for the first 120 days
- Court often grants extensions
- Once Exclusivity Period expires, anyone can file a Plan

Disclosure Statement

- The proponent of a Plan must obtain court approval of a Disclosure Statement.
- To be approved, a Disclosure Statement must contain adequate information to allow a person to make an informed decision about the Plan.
- A Disclosure Statement describes the history of the bankruptcy case, the Plan, and the proposal for payment of debts.
- Another good source of information

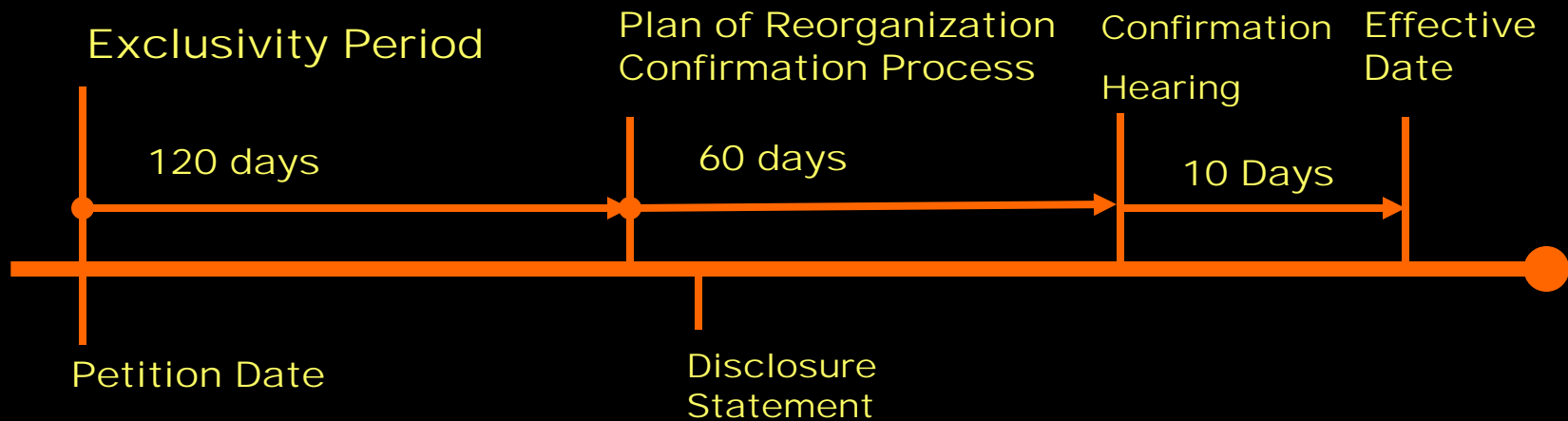
Voting

- After its Disclosure Statement is approved, the Plan proponent mails a copy of the Plan and Disclosure Statement to all creditors and shareholders.
- Creditors and shareholders submit votes to accept or reject the Plan.
- Claims are grouped in "classes" with similar claims.
- For a class to accept, need the votes of 2/3 in dollar amount and 1/2 in number.
- If less than 100% accept, can "cramdown" on rejecting classes.

Confirmation Hearing

Court determines whether Plan satisfies
all Bankruptcy Code requirements

Typical Chapter 11 Timeline



The End of A Bankruptcy Case

- Chapter 11
 - Confirmation of Plan
 - Effective Date of a Plan
 - Discharge/injunction
- Chapter 13
 - Confirmation of Plan
 - Discharge (when payments made in full)
- Chapter 7
 - Trustee's report of expected distribution
 - Creditors paid pro rata share
 - Discharge (individuals)

haynesboone
Setting precedent.

haynesboone
Setting precedent.

www.haynesboone.com