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**A PRIMER ON CORPORATE  
REORGANIZATION BY  
MEANS OF A  
CHAPTER 11 PROCEEDING**



## ACKNOWLEDGEMENT

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The purpose of this presentation is to provide an overview of the Chapter 11 Bankruptcy process for lay people who do not deal with these issues on a frequent basis. In this effort we reached out to several people for their help and assistance. We would like to recognize those people for their contributions to this presentation.

We would like to thank Melanie Rovner Cohen, Esq., Faye B. Feinstein, Esq. and Christopher Combest, Esq. of Quarles & Brady, LLP. They have developed teaching materials for the Certified Turnaround Professional course taught through a TMA affiliate. Much of the enclosed material is based on their overview of the bankruptcy process.

We would also like to thank Norm E. Gilkey, Esq. of Babst Calland Clements & Zomnir, PC for his numerous hours of editing this presentation to make sure that the legal section fairly represents the current legal environment.



***RECOGNIZING A  
TROUBLED SITUATION***



## THE TURNAROUND SITUATION

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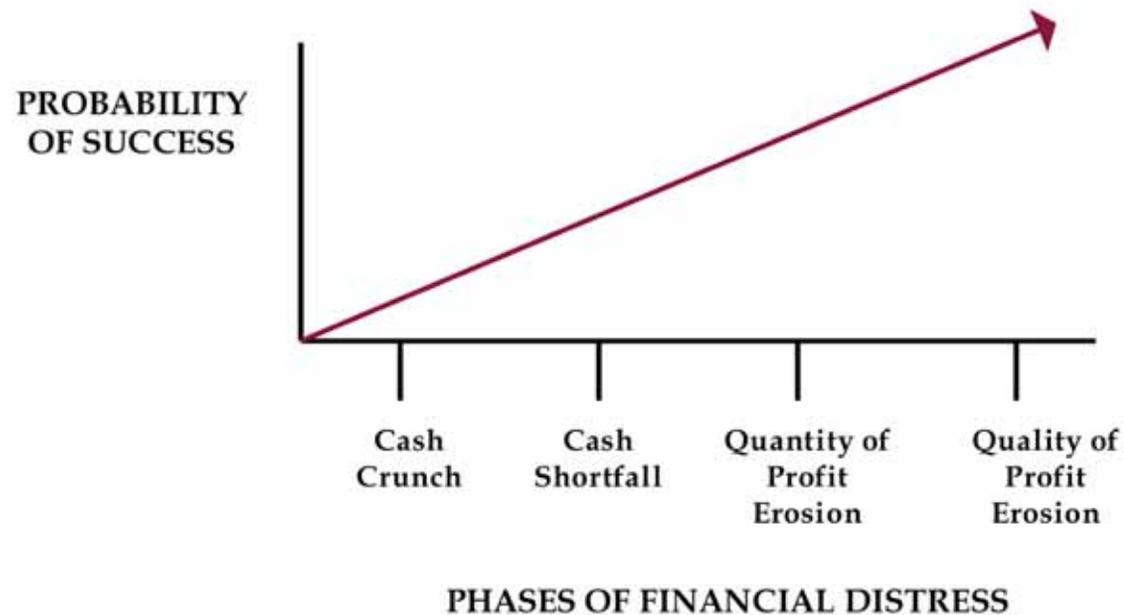
# SYMPTOMS OF A TROUBLED COMPANY

- Inability to pay debt service, taxes, contract obligations or accounts payable
- Inability to pay salaries, commissions, fringe benefits or pensions
- Inability to pay for capital improvements
- Excessive debt/equity ratio
- Flat or declining sales
- Eroding gross margin or operating margin
- Increasing labor or material costs as a percent of sales
- Increasing variable or fixed burden expenses as a percent of sales
- Increasing SG&A expenses as a percent of sales
- Inconsistent valuation of inventory
- Decreasing capacity utilization
- Declining unit sales or product line profitability
- Decreasing customer profitability



## THE TURNAROUND SITUATION

# EARLY RECOGNITION INCREASES THE PROBABILITY OF SUCCESS





## THE TURNAROUND SITUATION

# PHASES OF FINANCIAL DISTRESS

| <u>PHASE</u>               | <u>CHARACTERISTICS</u>   | <u>TIMING BEFORE<br/>CREDIT/CASH DISAPPEARS</u> |
|----------------------------|--|---|
| Quality Of Profit Erosion  | <ul style="list-style-type: none"><li>◆ Operating profit margins are declining</li><li>◆ Competition is increasing</li><li>◆ Net cash flow is steady or beginning to decline</li></ul>               | 9 To 18 Months                                  |
| Quantity Of Profit Erosion | <ul style="list-style-type: none"><li>◆ Company is beginning to show an operating loss</li><li>◆ Gross profit margins are shrinking</li><li>◆ Net cash flow is tightening</li></ul>                  | 6 To 12 Months                                  |
| Cash Shortfall             | <ul style="list-style-type: none"><li>◆ Cash is extremely tight</li><li>◆ Vendors are displeased with lateness of payments</li><li>◆ Bankers are concerned about financial situation</li></ul>       | 3 To 9 Months                                   |
| Cash Crunch                | <ul style="list-style-type: none"><li>◆ Overdrawn on bank account</li><li>◆ Line of credit is exhausted</li><li>◆ Vendors have company on COD basis</li><li>◆ Payrolls will soon go unpaid</li></ul> | NOW   |

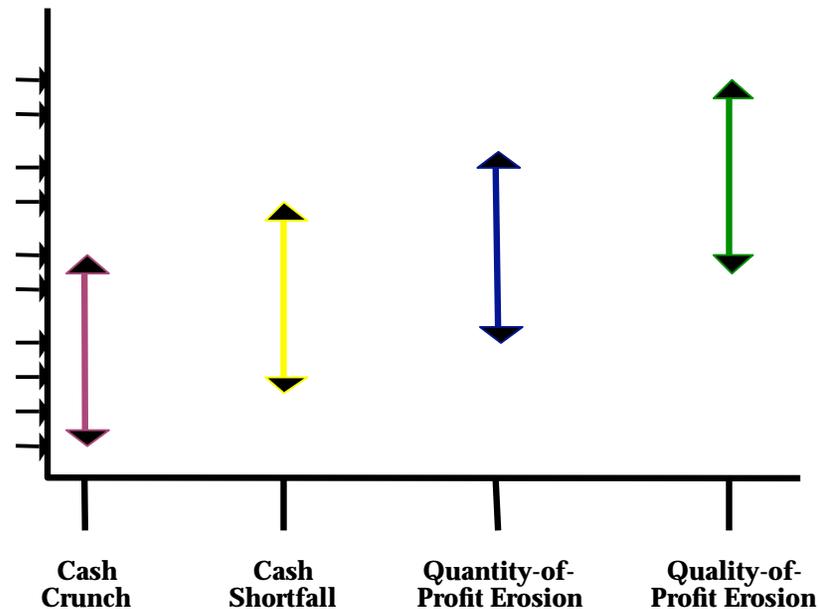


## THE TURNAROUND SITUATION

# EACH PHASE OF A TURNAROUND DICTATES DIFFERENT ACTIONS

### POTENTIAL ACTION:

- Increase Capacity Utilization
- Eliminate Unprofitable Operations
- Raise Prices
- Decrease Variable and Fixed Expenses
- Reduce Purchases
- Renegotiate Credit Lines and Debt Service
- Renegotiate Labor Contracts
- Factor Accounts Receivable
- "Fire Sale" Inventory
- Liquidate Excess Fixed Assets



### PHASES OF FINANCIAL DISTRESS



## THE TURNAROUND SITUATION

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### **A TURNAROUND SHOULD BE PURSUED WHEN:**

*THE VALUE OF THE TURNAROUND IS MORE THAN*

*THE VALUE OF LIQUIDATION*

*OR*

*THE VALUE OF THE BUSINESS ON A DISTRESSED SALE  
BASIS*



## RECOGNIZING A TROUBLED SITUATION

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### A CHAPTER 11 REORGANIZATION SHOULD BE CONSIDERED WHEN:

- Creditors are threatening to foreclose, execute on assets, or force the Company into bankruptcy.
- The Company needs time to construct a Reorganization Plan and does not presently have sufficient creditor support.
- The Company generally has the ability to maintain a positive cash flow while in Chapter 11, or will likely be able to sell its assets.
- The secured lenders are willing to support the Company in a reorganization proceeding, or their positions are such that they can be forced by the Bankruptcy Court to go along.

***An analysis of the above should involve the assistance of a bankruptcy lawyer and a turnaround consultant, experienced in representing distressed entities.***



***COMMON  
MISCONCEPTIONS  
ABOUT  
BANKRUPTCY***



## COMMON MISCONCEPTIONS

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**Myth 1: A Chapter 11 Reorganization cures business problems.**

*Truth: 85% of bankruptcy filings end in the death of the Company. Bankruptcy protection provides temporary relief, but core business problems must be resolved.*

**Myth 2: A Chapter 11 Reorganization can wipe out debt to the disadvantage of the secured lender and trade creditors, and to the advantage of the Company's shareholders.**

*Truth: Bankruptcy law provides priorities for reorganization of debt that puts shareholders behind lenders and trade creditors. In fact, equity can be totally wiped out.*

**Myth 3: A Chapter 11 Reorganization can provide relief from old payables.**

*Truth: Relief doesn't last long if the Company continues operating at a loss.*

**Myth 4: A Chapter 11 Reorganization frees up tight cash.**

*Truth: Companies often lose customers in bankruptcy and suppliers may demand payment in advance of shipping, which results in a further tightening of cash.*

**Myth 5: A Chapter 11 Reorganization provides quick relief from business problems.**

*Truth: Notice and hearing requirements of bankruptcy often lead to delays that jeopardize the business needs of the Company. Chapter 11 is normally a 12 to 18 month process but can go much longer.*



## COMMON MISCONCEPTIONS

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**Myth 6: In a Chapter 11 proceeding outcomes are sure and predictable.**

*Truth: The only thing certain in bankruptcy is uncertainty. Because of the courtroom process, parties outside the Company can ask for many things, with sometimes surprising judicial decisions.*

**Myth 7: If a Company cannot reach an acceptable workout with its creditors, it can force its will on them through the bankruptcy process.**

*Truth: While a Company can fail to survive for many reasons, it almost certainly will fail if it finds no common ground with at least its secured creditors, and preferably with unsecured creditors as well. In other words, constant battles typically lead to failure.*

**Myth 8: A Chapter 11 Reorganization is an inexpensive way to wipe out debt.**

*Truth: Bankruptcy is very expensive. A Company in Chapter 11 has all of the normal expenses PLUS professional and United States Trustee fees PLUS it is usually on a C.O.D. basis with its vendors. Smaller companies often do not survive the process, and mid-size companies struggle to endure.*

**Myth 9: If a Company gets into trouble, it should file for bankruptcy as soon as possible.**

*Truth: If circumstances permit, it is often better to delay filing in order to line up financing and begin preparation of a Reorganization Plan. A turnaround consultant/crisis manager and experienced legal counsel can be essential at this stage. It is crucial that they be brought in early, before actions are taken by management or creditors which could have long-term negative consequences.*



## COMMON MISCONCEPTIONS

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**Myth 10: A Company can use the threat of bankruptcy as a good negotiating technique to achieve an out-of-court workout.**

*Truth: Creditors begin to see the situation and management differently in contemplation of bankruptcy. Trade credit and borrowing availability can evaporate in an untimely manner, precipitating a filing.*

**Myth 11: If a distressed business needs to be sold, bankruptcy is the best way.**

*Truth: Buyers prefer to purchase distressed businesses via a bankruptcy proceeding. However, debtors and creditors may be better off via a foreclosure sale or other method that can provide good title and a faster closing.*

**Myth 12: If, within one year of filing, an owner takes money out of the Company to repay a loan he made to the Company to help it survive, he will be able to keep that money.**

*Truth: Any funds paid to an insider within one year of filing are subject to possible preference claims by the Bankruptcy Trustee or creditors.*

**Myth 13: If the Company's bankruptcy is due to mismanagement, the legal process itself is sufficient to bring the Company under control and to reorganize.**

*Truth: Poor managers need professional help to survive Chapter 11 and achieve reorganization. A turnaround consultant can help manage the crisis, analyze the situation, propose a workable Plan, add credibility to negotiations, and assist in the execution of business strategies and the Reorganization Plan. The legal process only provides the framework, not the solutions.*



***RULES GOVERNING  
THE CHAPTER 11 PROCESS***



## RULES OF BANKRUPTCY

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# PERTINENT CHAPTERS OF THE BANKRUPTCY CODE

- **Chapter 1: General Provisions, Definitions and Rules of Construction**
- **Chapter 3: Case Administration**
- **Chapter 5: Creditors, the Debtor and the Estate**
  - ❖ *The commencement of a bankruptcy case creates an Estate. The “Estate” is comprised of all of the Debtor’s property: real and personal; tangible and intangible.*
- **Chapter 7: Liquidation**
  - ❖ *Where the Bankruptcy Trustee collects the non-exempt assets of the Debtor, converts that property to cash , and distributes that cash to creditors.*
- **Chapter 11: Reorganization**
  - ❖ *Generally intended for debtor rehabilitation or reorganization, not liquidation of the debtors assets. It frequently involves a sale of the business to a third party.*
  - ❖ *Generally, in a Chapter 11 case, the Debtor may operate its business in the ordinary course and serves as its own Trustee. The Debtor is then referred to as the “Debtor in Possession”.*



## RULES OF BANKRUPTCY

# COMMENCEMENT OF A BANKRUPTCY CASE

- **A petition must be filed with the Bankruptcy Court to commence a case.**
- **A Debtor filed petition is considered “voluntary” and results in an immediate “order for relief.”**
- **A Creditor filed petition is considered “involuntary” and does not immediately result in an “order for relief.”**
  - ❖ *An involuntary filing must be signed by the requisite number of creditors. Generally, three creditors with unsecured claims totaling at least \$11,625 must join in the petition. If fewer than 12 unsecured creditors exist, a single creditor with at least \$11,625 in claims may file the petition.*
  - ❖ *The creditors filing the petition must prove that the Debtor is not paying its debts as they come due, unless such debts are the subject of a bona fide dispute.*
  - ❖ *The Debtor has the right to protest the allegations and sue for compensatory and punitive damages, if the petition was wrongfully filed.*
  - ❖ *An order for relief may be entered only after the Court approves the petition to move forward.*
  - ❖ *During the time between the filing of the petition and the entry of the order for relief, the Debtor may continue to use, acquire, or dispose of property in its normal course of business; but there are risks to creditors.*
  - ❖ *An involuntary bankruptcy may be filed under Chapter 7 or Chapter 11 of the Code and can be converted to another chapter if an order for relief is entered.*
  - ❖ *Creditors that transact business with the Debtor between the time of an involuntary filing and an “order for relief” are entitled to priority status with respect to those claims. However, priority status does not guarantee payment.*
  - ❖ *Most companies enter bankruptcy on a voluntary basis. It is unusual for creditors to force a company into bankruptcy.*



## RULES OF BANKRUPTCY

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### REQUIRED SCHEDULES UPON FILING (Voluntary)

- A list of all creditors, if voluntary; within 15 days of “order for relief”, if involuntary
- A schedule of assets and liabilities
- A schedule of current income and current expenditures
- A statement of Debtor’s financial affairs
- A statement of unexpired leases and executory contracts
- A list of all equity security holders within 15 days of “order for relief” in Chapter 11 cases.

***The quality of the information contained in these materials, and the quality of preparation, can set the tone for a Chapter 11 case (positively or negatively).***



***EFFECTS OF  
A CHAPTER 11 FILING***



## EFFECTS OF A CHAPTER 11 FILING

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**Upon entering Chapter 11, the Debtor receives the benefits of an Automatic Stay. A “Stay” means no action by creditors can be taken against the Debtor without Court approval, and until certain conditions have been met.**

- **Purpose of the Stay - to prevent creditors’ collection efforts so that the bankruptcy process can assist in distributing the Estate’s assets fairly among creditors with like standings.**
- **In addition, creditors are stayed from attaching or garnishing actions against the Debtor or its property.**
- **Unless modified by court order, the automatic stay will generally remain in effect while the Debtor is in Bankruptcy. Potential ways that parties may seek relief from the stay include:**
  - ❖ *The Debtor is unable to ensure a secured party that it will be protected from having the value of its lien position eroded. This is referred to as providing “adequate protection” and may be afforded either through (i) making cash payments; (ii) giving additional or substitute liens on other properties; or (iii) according other protections of equal value to the creditor.*
  - ❖ *If a secured creditor is injured due to lack of adequate protection, the creditor is entitled to a “super-priority” administrative claim and will be paid ahead of all other unsecured claims, including administrative expenses.*
  - ❖ *Other issues the Creditor must demonstrate to get a relief from stay:*
    - *The Debtor’s lack of equity in the property, and*
    - *The property is not necessary to an effective reorganization of the Debtor.*



## EFFECTS OF A CHAPTER 11 FILING

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### THE AUTOMATIC STAY

- **The automatic stay affects any party that asserts a claim against the Debtor or its property.**
- **According to the Bankruptcy Code, a “claim” means any right of payment or right to an equitable remedy for breach of performance, if this breach gives rise to a right of payment.**
- **The stay has certain limitations:**
  - ❖ *The stay only applies to claims that were “prior” to the filing. But creditors are wise to be cautious even if claims arose during the Chapter 11 proceeding.*
  - ❖ *The stay does not affect certain acts to perfect a security interest or acts by lessors to regain possession of nonresidential real property leased to a Debtor under a lease that expired before or during a bankruptcy case.*
  - ❖ *Government entity’s police powers are not stayed.*
- **The Court must act within 30 days after a creditor moves for relief. If not, the stay pertaining to this creditor is automatically lifted. But creditors should still be cautious.**



## EFFECTS OF A CHAPTER 11 FILING

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### PROPERTY OF ESTATE

- The Estate's property includes all of the Debtor's real and personal property; tangible and intangible property; all property in the possession of the Debtor, and any property held by a third party but owned by the Debtor.
- Assets held by the Estate but owned by a third party (i.e., Letters of Credit, consigned goods) are not property of the Estate.
- Any interest in property that the estate acquires after the commencement of the case (i.e., purchased raw material).
- Property that is burdensome to the Estate or of inconsequential value and benefit can be abandoned by the Debtor or Bankruptcy Trustee, if one was appointed. Abandoned property is no longer Estate property and is not applicable to the automatic stay. Creditors may take whatever action that was available to them prior to the bankruptcy petition. For example, they can move to foreclose on the property.



## EFFECTS OF A CHAPTER 11 FILING

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### **CONVERSION OF A CHAPTER 11 CASE TO A CHAPTER 7**

**In a Chapter 11 proceeding, a party in interest may request that the Bankruptcy Court convert the Debtor's case to a Chapter 7, if it can show cause. "Cause" includes:**

- Continuing loss to, or reduction in, Estate value with little likelihood of regaining its value.
- Inability of the Debtor to develop and implement a Reorganization Plan that is acceptable to creditors.
- Delays by the Debtor that could cause harm to the creditors.
- Denial of confirmation of Plans by creditors or denial of requests for more time.
- The Court revoking an order of confirmation.
- Inability to successfully implement a previously confirmed Plan.
- A significant default under the confirmed Plan by the Debtor.
- Failure to pay any required fees or expenses.

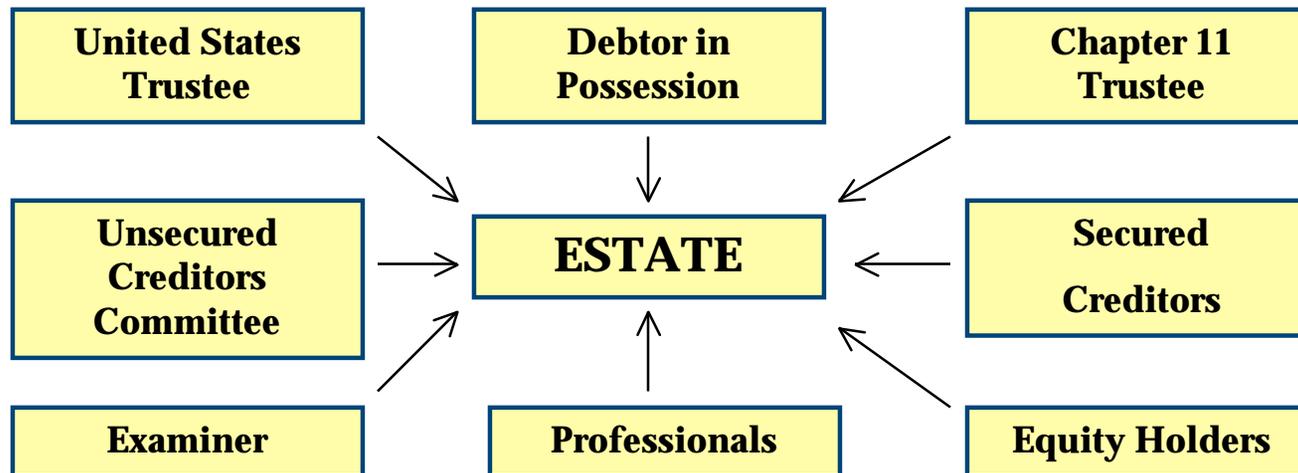
***Debtor can also convert on its own, unless the case started involuntarily.***



***PARTIES IN INTEREST TO A  
CHAPTER 11 PROCEEDING***



## PARTIES TO A CHAPTER 11 PROCEEDING



*Fees and expenses of professionals appointed by the Court to represent parties with fiduciary duties to the Estate (Debtor, Committees, Chapter 11 Trustee, if any) are paid by the Debtor's Estate after Court approval. An over-secured, secured creditor can also request that its professionals be paid by the Debtor's Estate. This is also subject to Court approval.*



## PARTIES TO A CHAPTER 11 PROCEEDING

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### UNITED STATES TRUSTEE

- **A government official, appointed by the Attorney General.**
- **Created by Congress to handle administrative burden, rather than Bankruptcy Judges.**
- **Specific responsibilities include:**
  - ❖ *Develop, maintain and supervise a group of private trustees, primarily for Chapter 7 liquidations.*
  - ❖ *Appointing initial trustee in Chapter 7 case.*
  - ❖ *Serving as a trustee themselves, when required. (This is rare.)*
  - ❖ *Calling the first creditors meeting (Section 341 Meeting).*
  - ❖ *Preventing dishonesty during process, has standing to be heard on any relevant issue.*
  - ❖ *Reviewing monthly Chapter 11 reports filed by Debtor.*
- **Unlike a Chapter 7 or Chapter 11 Trustee, the U.S. Trustee does not have actual authority over a Debtor's Estate.**

*U.S. Trustee's involvement can range from inactive to very active in any given Chapter 11.*



## PARTIES TO A CHAPTER 11 PROCEEDING

# BANKRUPTCY TRUSTEE

### ➤ Chapter 7 Trustee:

- ❖ *Appointed on an interim basis, by U.S. Trustee.*
- ❖ *Appointment affirmed or rejected during first meeting of creditors, usually affirmed. Only unsecured creditors may vote during this election due to their position furthest down the claim hierarchy.*
- ❖ *Duties include:*
  - *Collecting and liquidating the Estate's property.*
  - *Investigating the financial affairs of the Debtor.*
  - *Examining proofs of claim.*
  - *Pursuing preference and other avoidable actions.*

### ➤ Chapter 11 Trustee:

- ❖ *Rare. Function normally provided by Debtor themselves through Debtor in Possession ("DIP"). DIP has most of the responsibilities of a Chapter 11 Trustee, with the exception of investigating its own financial affairs or alleged wrongdoing.*
- ❖ *The Court may appoint a Chapter 11 Trustee to replace the DIP following a request by a party in interest predicated on:*
  - *Fraud, dishonesty, incompetence or gross mismanagement by DIP, or*
  - *The appointment is in the best interests of creditors, equity and other interests of the Estate.*
  - **If the court agrees that a Chapter 11 Trustee is warranted, creditors have 30 days to request a meeting for the purpose of electing a Trustee. If no such meeting is requested, the U.S. Trustee may appoint a "disinterested" person to the position.**



## PARTIES TO A CHAPTER 11 PROCEEDING

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### EXAMINER

- **If the Court declines to authorize a Chapter 11 Trustee, it may upon the request of a party in interest, order the appointment of an Examiner charged with investigating allegations of such claims brought under original request for a Chapter 11 Trustee. The Court must find that:**
  - ❖ *It is in the best interests of creditors and other parties with interests in the Estate to have an Examiner or*
  - ❖ *Debtor's fixed, liquidated, unsecured debts, other than trade, taxes and of owing to an insider exceeds \$5,000,000.*
- **An Examiner is generally only appointed in large Chapter 11 cases, if at all.**
- **The Examiner has responsibility for investigating specific allegations brought by parties in interest or any other issues the Court may authorize.**



## PARTIES TO A CHAPTER 11 PROCEEDING

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### HIRING PROFESSIONALS

- Prior Court approval required before the hiring of any “professional person” by Trustee, DIP or committees. Courts to consider certified professionals and those with demonstrated skills in the bankruptcy field.
- Includes attorneys, accountants, appraisers, auctioneers, consultants, and investment bankers, who are disinterested persons.
- Professionals must file application for payment of fees and expenses by the Estate.
- Court can now approve fees on a fixed or percentage basis.



## **PARTIES TO A CHAPTER 11 PROCEEDING**

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### **COMMITTEES**

- At the beginning of the case, the Chapter 11 Debtor must file a list of its creditors, schedule of assets and liabilities, schedule of current income and expenditures, and a statement of the debtor's financial affairs.
  
- As soon as practical, the U.S. Trustee appoints a committee of creditors holding unsecured claims and may appoint additional committees of creditors or equity security holders as they deem appropriate.
  
- Committees ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented by the committee.



## PARTIES TO A CHAPTER 11 PROCEEDING

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# UNSECURED CREDITORS COMMITTEE

- **Responsibilities include:**
- ❖ To review and advise the Court of the Committee's position on motions or other legal actions.
  - ❖ To consult with the Debtor throughout the case with respect to case administration.
  - ❖ To investigate the Debtor's pre-petition conduct for possible causes of action against insiders that would benefit the estate (e.g., preferential transfers).
  - ❖ To determine the desirability of the continuance of such a business.
  - ❖ To request the appointment of a Chapter 11 Trustee or Examiner, if it deems necessary.
  - ❖ To advise other unsecured creditors on whether to accept or reject the Plan(s).
  - ❖ To appear at various hearings as a party in interest.
  - ❖ To prepare and file its own Plan, if appropriate, when the Debtor ceases to have the exclusive right to do so. This Creditors' Plan should maximize the recovery to the Committee's constituency.
  - ❖ To consult with other parties in interest throughout the case. The Committee must provide access to information to creditors not on the committee.
  - ❖ To hire professionals (attorneys and financial consultants).



## PARTIES TO A CHAPTER 11 PROCEEDING

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### DEBTOR IN POSSESSION

- To successfully reorganize, the Debtor's business must remain viable during the Chapter 11.
  
- The Bankruptcy Code specifically enables the pre-bankruptcy management to retain control of the daily activities of the firm. However, DIP can be challenged by creditors, the U.S. Trustee, or other parties in interest.
  
- Court will let the DIP stay in control unless a meritorious request by a party in interest is made to appoint a Chapter 11 Trustee.
  
- Sometimes the DIP remains in control, but a turnaround consultant is brought in to evaluate the situation and report to all parties in the case.

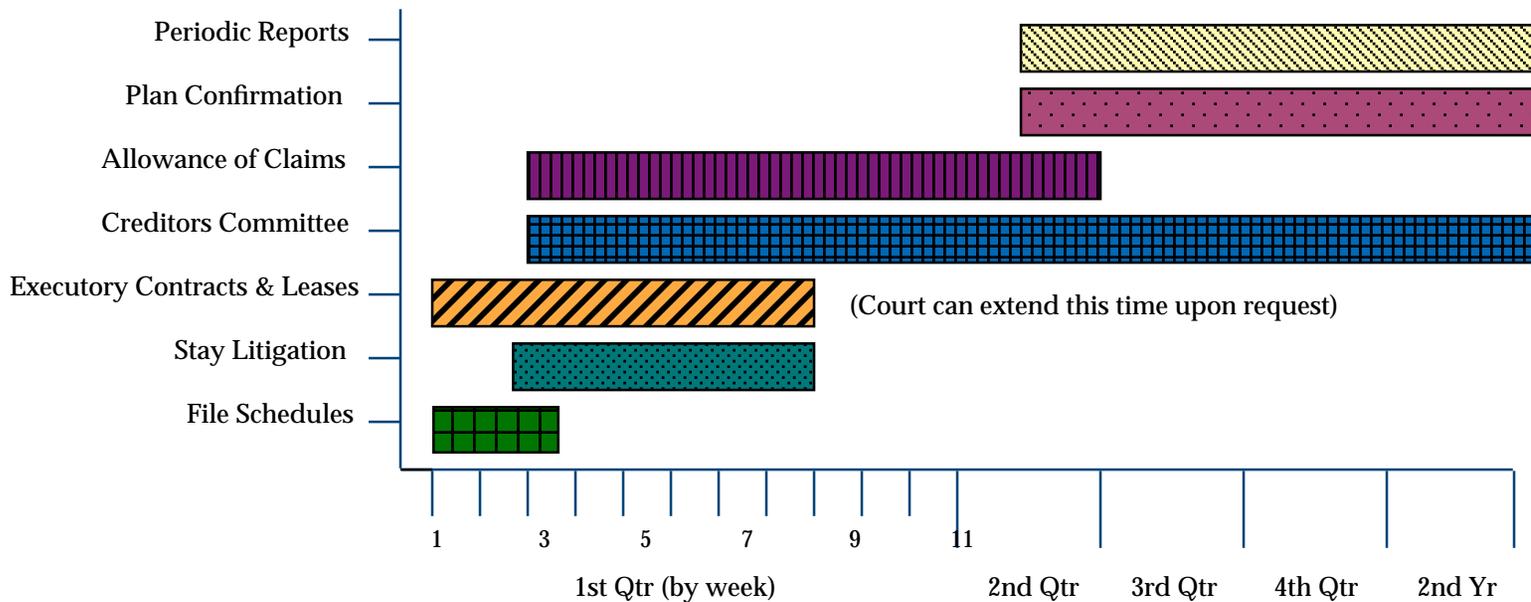


***THE CONFIRMATION PLAN  
PROCESS FOR CHAPTER 11***



## THE CONFIRMATION PLAN PROCESS

### TYPICAL TIMEFRAME FOR PROCESS (Average Chapter 11 to a Confirmed Plan can take 18 months)





## THE CONFIRMATION PLAN PROCESS

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### TIMING

- **A Plan of Reorganization may be filed simultaneously with the bankruptcy petition, or anytime after that. Once confirmed, it operates as a discharge.**
- **The first 120 days of the case is referred to as the “Exclusivity Period”, where the Debtor-in-Possession has the exclusive right to file a Reorganization Plan. If it files a Plan during this time, no one else can file a competing plan during the first 180 days of the case.**
- **The Debtor can request the Court to extend this period. Normally, a Court will give an extension which can be up to 18 months. However, the Court always has the power to eliminate or shorten time periods for cause.**
- **Once the Exclusivity Period ends, any party in interest may file a Plan if one of the following apply:**
  - ❖ *A Chapter 11 Trustee is involved.*
  - ❖ *The Debtor’s Plan has not been accepted within 180 days after petition for Bankruptcy was filed.*
- **Special timing rules:**
  - ❖ *For those Debtors who are eligible and chose to be treated as a “small business,” the Exclusivity Period is only 100 days with a maximum of 160 days from the date the petition was filed; and the Court has the ability to reduce either of these periods.*
  - ❖ *The timing for Debtors in single asset real estate cases is 90 days from the filing date.*



## THE CONFIRMATION PLAN PROCESS

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### TIMING

(Continued)

- **Debtor has an initial Exclusivity Period of 120 days to file a Chapter 11 Plan along with a Disclosure Statement, but that can be and often is extended. However, the Period shall not be extended beyond 18 months and confirmation beyond 20 months.**
- **After a minimum of 25 days, a hearing is held on the Disclosure Statement.**
- **Ballots are sent out. Impaired creditors and shareholders file ballots, accepting or rejecting the Plan.** *An “impaired” creditor is essentially a creditor not being paid in full at the Confirmation of the Plan.*
- **After a minimum of another 25 days, a Confirmation hearing is held to consider any objections to the Plan and Confirmation of the Plan.**
- **Court enters order confirming the Plan of Reorganization.** *Confirmation constitutes a discharge from bankruptcy and forms a new set of contractual arrangements between the Debtor and its creditors based upon the Plan.*
- **Plan is consummated by initial payments to creditors and cannot be modified after this point, absent fraud.**
- **Court enters final decree closing the case. After decree, the Debtor continues to perform under a Reorganization Plan that may extend for many years.**
- **The median time from filing to Confirmation of a Plan is between one and two years. A Prepackaged Plan may be confirmed in as little as two to three months.**



## THE CONFIRMATION PLAN PROCESS

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### CONTENTS OF PLAN

- **The mandatory provision for a Reorganization Plan are set out in the Code:**
  - ❖ *Designate classes of claims or classes of interests.*
  - ❖ *Specify any class of claims or interests that is not impaired under the Plan. A class is not impaired if that group of creditors receives all amounts of money owed to it and its legal and contractual rights remain the same.*
  - ❖ *Specify the treatment of class of claims or interests that is impaired.*
  - ❖ *Treat each claim or interest within a class equally.*
  - ❖ *Provide adequate means for the Plan's implementation.*
  - ❖ *Provide for the distribution of voting power among classes of securities possessing voting power.*
  - ❖ *Contain only provisions that are consistent with the interests of creditors and equity security holders.*
  
- **Classification of claims or interests:**
  - ❖ *All claims or interests must be properly classified in the Plan so that substantially similar claims or interests are categorized together. For example, unsecured trade payables are not in the same class as secured bank loans.*
  - ❖ *All claimants within a class must be treated the same.*



## THE CONFIRMATION PLAN PROCESS

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# CONFIRMATION OF PLAN

- **The Bankruptcy Court must review the Plan to ensure that it conforms with statutory guidelines.**
- **The Plan must pass the “best interests of the creditors” test. The test provides that each creditor in an impaired class either:**
  - ❖ *Accepts the Plan; or*
  - ❖ *Receives under the Plan no less than it would receive in a Chapter 7 liquidation.*
- **At least one impaired class under the Plan has to accept the Plan for it to be confirmed:**
  - ❖ *A class accepts the Plan if (a) at least 2/3rds in dollar amount of voting creditors; and (b) over 1/2 in number of those actually voting approve the Plan.*
  - ❖ *An unimpaired class may not vote since it is assumed that it will accept the Plan.*
- **Prior to confirmation, all bankruptcy case administration fees must have been paid.**
- **Under the Plan, administrative and priority claims must be paid entirely. (*Can be modified by agreement.*)**
- **The Plan must have a reasonable prospect of succeeding.**



## THE CONFIRMATION PLAN PROCESS

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### CRAMDOWN

- **Since it only takes one impaired class to vote in favor of the Plan for it to be Confirmed, the Court can determine that it is in the best interests of all parties to confirm the Plan over the objection of a dissenting class or classes, providing that all of the other requirements for confirmation are met. This is referred to as a “cramdown”. The Court will choose this procedure if:**
  - ❖ *The proponent (usually the Debtor) requests the Court for a cramdown of the Plan.*
  - ❖ *The Plan does not discriminate unfairly and is fair and equitable to each impaired class or interest that rejected the Plan.*
  
- **A cramdown cannot occur if the Debtor is administratively insolvent, unless the administrative creditors agree to a reduction or agree to be paid over time.**
  
- **To be considered “fair and equitable” to secured creditors, it must do one of the following:**
  - ❖ *Provide for the secured creditor to keep its lien and to receive deferred cash payments totaling at least the allowed amount of such claim; and as of the effective date of the Plan, the value must be at least as much as the interest in the estate property.*
  - ❖ *Provide for the sale of any property that is subject to the liens securing such claims to be free and clear of such liens.*
  - ❖ *Give the creditor a substantially similar position for its claim.*



## THE CONFIRMATION PLAN PROCESS

### CRAMDOWN (Continued)

- **In order for a Plan to be “fair and equitable” to unsecured creditors, it must conform to the “absolute priority rule.”**
  - ❖ *The absolute priority rule provides that if the class is impaired, then they must be paid in full or, if paid less than in full, then no junior class may receive anything under the Plan.*
  - ❖ *There is a doctrine that modifies the absolute priority rule. It is known as the “new value exception.” A junior class (i.e. the Debtor’s equity) may acquire an interest in the reorganized Debtor, even if senior classes are not paid in full, if the junior class makes a contribution:*
    - *In money;*
    - *Essentially equal to the value of the new equity interests given in exchange; and*
    - *Required for the implementation of a feasible Plan.*
  - ❖ *For example, if a class of trade creditors is not paid in full, then the equity holders cannot keep their stock unless the creditors consent. However, if the equity holders provide new consideration to the transaction, then they can keep some or all of their interest. The amount of consideration varies and depends upon the value of the company and whether or not the creditors believe the company can succeed without the present equity holders.*
  - ❖ *Negotiations during the Chapter 11 proceeding between various parties in interest frequently modify the strictness of this requirement.*



## THE CONFIRMATION PLAN PROCESS

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### PREPACKAGED FILING

- **The most cost effective and efficient method of going through a Chapter 11 proceeding is through what is known as a “prepackaged” process.**
- **The legal process is the same as a normal filing but the sequence of events differ.**
- **The key elements of a prepackaged bankruptcy are that prior to filing, the following has occurred:**
  - ❖ *An Unsecured Creditors Committee has been selected.*
  - ❖ *Debtor-Unsecured Creditors Committee negotiations have taken place and the Committee is supportive of the Plan.*
  - ❖ *A disclosure statement and Reorganization Plan has been prepared.*
  - ❖ *Creditors’ acceptances of the Reorganization Plan are in place .*
- **Debtor will file a Reorganization Plan with, or near to, when its petition is filed.**



## THE CONFIRMATION PLAN PROCESS

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# PREPACKAGED FILING

## (Continued)

- **Benefits:**
  - ❖ *Minimize the time spent in bankruptcy.*
  - ❖ *Cheaper. (Greatly reduced professional fees)*
  - ❖ *Less disruption to the Debtor's business.*
  - ❖ *All parties have more control over the process.*
  
- **Disadvantages reflect the fact that most efforts occur prior to filing. Therefore:**
  - ❖ *Debtor does not have the protection of a Chapter 11 while negotiating.*
  - ❖ *There is no automatic stay.*
  - ❖ *There is no formal ability to reject unfavorable contracts.*
  - ❖ *There is no moratorium on the accrual of interest on unsecured debts.*

***In general, a prepackaged Chapter 11 filing is more suited for a Debtor looking for help with its highly leveraged capital structure than a Debtor looking for help with its trade debt. In other words, a company with financial difficulties rather than operational problems should consider this option.***



## THE CONFIRMATION PLAN PROCESS

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### POST-CONFIRMATION

- Once a Plan is confirmed by the Bankruptcy Court, the Debtor's obligations are governed by the terms of the Plan.
- The Plan will not only bind the Debtor but also the Debtor's creditors and shareholders.
- A confirmed Plan binds all parties, whether or not they voted for the Plan and even if they voted against it.
- The Bankruptcy Court has authority to enforce the Plan.



***CLAIMS AND  
INTERESTS***



## CLAIMS AND INTERESTS

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### PROOFS OF CLAIM OR INTEREST

- **Creditors file proofs of claims.**
- **Equity holders file proofs of interest.**
- **Filing serves notice that a party is claiming an interest in the Debtor's Estate.**
- **In Chapter 7, proofs must be filed within 90 days after the date set for the First Meeting of Creditors (referred to as the 341 hearing). This deadline is known as the "bar date". If not filed within timeframe, creditor moves down distribution order established in Section 726. Since each class must be fully satisfied before the next class is compensated, this failure usually results in zero recovery. Secured creditors do not have to file claims, if they are willing to look only to their collateral for a recovery.**
- **In Chapter 11, bar date is set by the Bankruptcy Court.**
  - ❖ *Creditors receive at least 20 days notice.*
  - ❖ *Creditors must file a proof of claim only if the Debtor did not list claim on its schedules, or the amount listed is disputed, contingent, or unliquidated.*
  - ❖ *Creditors are deemed to have filed so long as their claim was on the original list of creditors and is undisputed.*

***General rule of thumb: Always file a Claim on a timely basis.***

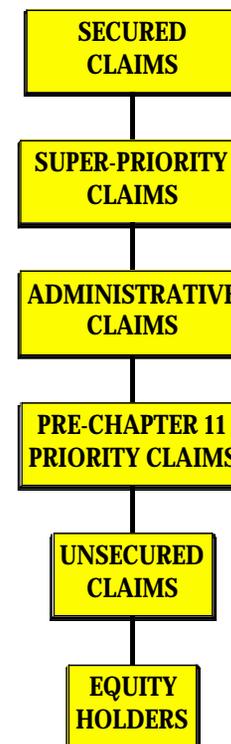


## CLAIMS AND INTERESTS

### DISTRIBUTION OF ESTATE'S ASSETS TO THE VARIOUS CLASSES OF PARTIES OF INTEREST IN THE ESTATE

Distributions from the Estate are prioritized. Each class must be fully satisfied before the next class will receive any distribution, unless the senior claimant otherwise consents.

Secured claims are paid first. Once these claims are fully satisfied, super-priority claims and then administrative and priority claims are next to receive distributions. Again, once fully satisfied, unsecured claims are then paid. If any funds remain to be distributed from the Estate, the equity holders will receive the final distribution.





## CLAIMS AND INTERESTS

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### SECURED AND UNSECURED CLAIMS

- **A secured creditor has a “secured claim” in an amount equal to the value of the lien or interest against the Debtor’s property.**
- **An unsecured creditor is a claimant whose claim is not secured by collateral.**
- **An undersecured creditor is a secured creditor who holds a claim for more than the amount of the value of the collateral securing the debt.**
  - ❖ *An undersecured creditor’s claim will be divided into:*
    - *A secured claim equal to the value of the collateral; and*
    - *An unsecured claim for the residual amount owed.*
- **An oversecured creditor is a secured creditor whose collateral is worth more than its claim.**
  - ❖ *Entitled to post-Chapter 11 interest on claim.*
  - ❖ *Entitled to reasonable fees and expenses expressly provided in the instrument establishing the security interest.*
  - ❖ *These additional claims are limited to surplus of collateral value over security interest.*



## CLAIMS AND INTERESTS

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### **PRIORITY CLAIMS - These are unsecured claims that are given priority above all general unsecured claims.**

- **Certain unsecured claims are given a “priority status” (Section 507 claims) in bankruptcy:**
  - ❖ *Expenses incurred in the administration of the Debtor’s Estate, including professional fees.*
  - ❖ *Claims arising post-bankruptcy in the ordinary course of business (e.g., trade credit).*
  - ❖ *Pre-Chapter 11 wage claims including vacation, severance and sick leave pay up to \$10,000 per employee and restricted to certain time requirements.*
  - ❖ *Certain pre-Chapter 11 contributions to employee benefit plans.*
  - ❖ *Most pre-Chapter 11 taxes.*
  - ❖ *Certain reclamation claims*
  
- **Each priority unsecured claim must be paid in full before general unsecured claims receive any distribution, unless otherwise agreed.**
  
- **A creditor may have a “super-priority claim”, payable ahead of all other priority claims, to the extent that the creditor’s “adequate protection” expectation proves insufficient. Many times this happens with a lender providing some form of a working capital loan.**



## CLAIMS AND INTERESTS

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# EQUITABLE SUBORDINATION

- Equitable Subordination allows the Court to reorder the priority of claims of any creditor.
- Typically, a claim may be subordinated when an equity holder also has claims against the Estate as a creditor (e.g., a shareholder loan).
- In general, the Court will only take this action when the creditor's conduct has injured the Estate or other creditors.



***CASH ISSUES FOR THE  
DEBTOR-IN-POSSESSION***



## DEBTOR-IN-POSSESSION CASH ISSUES

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### INDUCEMENTS TO GETTING THIRD PARTIES TO EXTEND CREDIT

- **The Bankruptcy Court does not need to approve the Debtor assuming unsecured (trade) debt and acquiring unsecured (trade) credit in the ordinary course of business. These claims are allowable as priority administrative claims.**
  
- **The Court may also give an administrative expense priority for unsecured credit transactions that are not incurred in the ordinary course of business.**
  
- **The Court may grant a creditor certain rights in order for the Debtor to gain financing. These include:**
  - ❖ *Granting super-priority status over all other administrative expenses.*
  - ❖ *Giving a lien on unencumbered property owned by the Debtor.*
  - ❖ *Extending a lien on encumbered property equal or senior to existing liens. However, “adequate protection” to the current lienholders’ interests must be proven first.*



## DEBTOR-IN-POSSESSION CASH ISSUES

### CASH COLLATERAL

- **One of the first actions taken by the Debtor after filing for Chapter 11 is to request the Bankruptcy Court to allow for the use of a secured creditor's cash collateral. Cash collateral is defined as cash derived from other collateral (i.e., inventory sale proceeds, accounts receivable collections, etc.) and may include:**
  - ❖ *Cash and cash equivalents*
  - ❖ *Negotiable instruments*
  - ❖ *Documents of title*
  - ❖ *Marketable securities and deposit accounts*
  
- **The Court must give authorization to the Chapter 11 Trustee or DIP to use the cash collateral or the Debtor must get the secured creditor's consent. Frequently, the cash collateral is pledged to a secured creditor and its use is subject to ensuring that the creditor's lien position is not diminished through the use of the cash.**
  
- **To gain Court approval for the use of cash collateral, the creditor's secured interest must be shown to have "adequate protection".**

*A Chapter 11 has a much better chance of succeeding if, prior to the filing, the secured creditor and Debtor prepare their cash collateral arrangement and jointly present it to the Bankruptcy Court immediately after filing. A successful Chapter 11 requires planning. When a Debtor waits until the last minute, matters have reached a crisis level, often resulting in poor execution of Chapter 11 process.*



## DEBTOR-IN-POSSESSION CASH ISSUES

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### ADEQUATE PROTECTION

- **A secured creditor is given adequate protection in exchange for the use of the collateral securing its lien.**
  
- **There are several situations where adequate protection may be required:**
  - ❖ *With the use, sale or lease of property.*
  - ❖ *With receiving financing on a post-petition basis.*
  - ❖ *To prevent the lifting of the automatic stay for a specific creditor.*
  
- **Consideration is given to ensure that adequate protection is maintained when a creditor's lien value declines:**
  - ❖ *Cash payments.*
  - ❖ *Additional or replacement liens.*
  - ❖ *Granting substitute collateral of equal value.*
  
- **Adequate protection may not be demonstrated solely via the granting of administrative priority status to a claim.**



***AVOIDING  
TRANSFERS***



## AVOIDING TRANSFERS

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**In Chapter 11, the Code allows a Debtor-in-Possession or the Chapter 11 Trustee to “avoid” certain transfers. This means that a transfer that was already made can be rescinded or cancelled. Areas of avoidance include:**

- Statutory liens
- Preferential transfers
- Fraudulent transfers
- Recovering an amount of setoff
- Reclamation
- The voluntary return of goods by the Debtor



## AVOIDING TRANSFERS

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### STATUTORY LIENS

- **A statutory lien are created via state law and do not require the Debtor's consent.**
- **Statutory liens are liens such as:**
  - ❖ *Landlord's liens*
  - ❖ *Mechanic's liens*
  - ❖ *Tax liens*
- **The lien may be avoided if:**
  - ❖ *It was not perfected before the bankruptcy filing, meaning that there are no legitimate security agreements, and UCC-1 statements on record for the assets in question.*
  - ❖ *It is a landlord's lien.*
  - ❖ *The lien first became effective when (a) the bankruptcy case commenced; (b) an insolvency proceeding began outside of bankruptcy; (c) the Debtor became insolvent; (d) a third party, not the lienholder, executed upon the Debtor's property; or (e) an appointed custodian took possession of the Debtor's assets.*



## AVOIDING TRANSFERS

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### PREFERENTIAL TRANSFERS

- **A preferential prepetition transfer occurs when one creditor receives preferential treatment over other creditors prior to the filing.**
  
- **It must be demonstrated that:**
  - ❖ *A transfer of the Debtor's property occurred that was for the benefit of a creditor. Payments by third parties generally do not apply (e.g., a guarantor makes a loan payment for the Debtor).*
  - ❖ *The transfer was for debt incurred prior to the transfer.*
  - ❖ *The Debtor was insolvent when the transfer took place.*
  - ❖ *The transfer happened within 90 days prior to the date the bankruptcy petition was filed (or one year, if the transferee was an "insider").*
  - ❖ *The transferee (creditor) was given more than it would have received in a Chapter 7 liquidation.*
  
- **The transfer could have been made straight to the creditor (direct preference) or to a third party for the benefit of the creditor (indirect preference).**
  - ❖ *An example of a direct preference is where a Debtor made a COD plus 20% payment for new merchandise, where the 20% was applied to old bills. The 20% is potentially a voidable preference.*
  - ❖ *An indirect preference example is where a Debtor paid a distributor-vendor for an old debt and then the distributor paid the manufacturer its portion of the amount due. The entire amount is potentially a voidable preference.*



## AVOIDING TRANSFERS

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### PREFERENTIAL TRANSFERS (Continued)

- **A fully-secured creditor cannot receive a preference because it would be paid the same amount in liquidation.**
- **A preference cannot exist if the Estate is financially capable of satisfying all claims (i.e., not insolvent). A test for whether a preference issue exists generally is met when the transferee is an unsecured or undersecured creditor and the Estate can not pay all of the creditors' claims in full.**
- **Insider preference payments that were made within one year of the date of filing may be recovered, meaning that the insiders must return the money. Insiders include:**
  - ❖ *Directors, officers, and other persons in control of the Debtor or their relatives.*
  - ❖ *Any affiliate entities of the Debtor or an insider of such an affiliate entity.*
- **For the additional period relating to insider transactions, the Debtor's insolvency at the time of transfer must be proven, which is not that difficult to demonstrate in most cases.**



## AVOIDING TRANSFERS

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### PREFERENTIAL TRANSFERS (Continued)

- **Generally, preference actions must be brought within two years after the order for relief, or within three years, if a Chapter 11 Trustee is appointed to replace a Debtor-in-Possession. Action to recover moves to the district of the creditor.**
- **Floor of \$5,000.**
- **Defenses to preferences actions include:**
  - ❖ *There was a contemporaneous exchange for new value.*
  - ❖ *The transfer was made in the ordinary course of business between the parties or in the industry.*
  - ❖ *The transfer was a security interest in property, where a loan was made to finance the purchase.*
  - ❖ *If a creditor makes additional post-preference unsecured loans to Debtor, it is allowed to setoff up to the amount of the additional loan.*
  - ❖ *Floating liens on accounts receivable and inventory, which are permitted as long as the creditor's position has not improved.*
  - ❖ *Statutory liens (e.g., mechanic's liens and tax liens), which are generally not avoidable.*



## AVOIDING TRANSFERS

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### FRAUDULENT TRANSFERS

- **Two years before the Bankruptcy petition filing date. This means that the Bankruptcy allows for a reach-back prior to the filing of the bankruptcy petition. Strong arm powers can extend that period significantly under state law (four years or more).**
- **Modeled after the Uniform Fraudulent Conveyance Act.**
- **“Actual” fraud indicators:**
  - ❖ *The transaction was purposely hidden.*
  - ❖ *The parties agreed not to record the transfer.*
  - ❖ *The transfer price was below fair market value.*
  - ❖ *The transfer occurred at a time that the Debtor was being chased by creditors.*
- **“Constructive” fraud indicators:**
  - ❖ *For the transfer, the Debtor received below reasonable value while:*
    - ❖ *Insolvent at the time of transfer or became insolvent as a result of the transfer;*
    - ❖ *Having little capital remaining to operate the business*
    - ❖ *Knowing it would incur additional debts that it would be unable to pay.*
  - ❖ *Intent of Debtor is irrelevant.*



## AVOIDING TRANSFERS

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### SETOFF AND RECLAMATION

- **Setoff is where a creditor has a right to offset unpaid obligations from the Debtor to the creditor against either the Debtor's Estate or against further obligations of creditor to the Estate. (For example, a bank, as a secured creditor that is holding funds of the Debtor, may setoff against the bank accounts of the Debtor for sums owed on the loans.) Issues regarding setoffs include:**
  - ❖ *There may be a 90 day preference issue (or one year for insiders).*
  - ❖ *If the creditor's position improved, Chapter 11 Trustee may recover that amount.*
  
- **Reclamation is the right of a seller of goods to have those goods returned from an insolvent buyer. Issues regarding reclamation include:**
  - ❖ *Sale must have been in the ordinary course of business.*
  - ❖ *Sale must be for goods sold on credit within 45 days of filing.*
  - ❖ *Vendor must make demand for the goods within a specified timeframe (20 days of receipt).*
  - ❖ *Debtor must have been insolvent at time of receipt.*
  - ❖ *Seller who has a valid claim may (a) get the goods returned, (b) have an administrative claim, or (c) have a priority claim, (d) secure a lien on property.*
  - ❖ *Recognizes secured creditors' prior floating liens.*



***LEASES AND EXECUTORY CONTACTS***  
***AND***  
***UNEXPIRED LEASES***



## LEASES AND EXECUTORY CONTRACTS AND UNEXPIRED LEASES

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- **Executory contracts are any contracts where the Debtor and the other party still have requirements to perform for each other, prior to the filing of the petition. This may include leases, management contracts, or other forms of contracts.**
- **The Debtors options are to:**
  - ❖ *Reject contract/lease.*
  - ❖ *Assume and retain contract/lease.*
  - ❖ *Assume and assign contract/lease.*
- **If Debtor is lessee of non-residential real property, the Debtor must assume or reject the lease within 120 days after the order for relief to keep in place. The Bankruptcy Court may extend this for 90 days. The lease is deemed “rejected” if the debtor does not affirmatively assume the lease. The time period to accept or reject the lease is limited to 210 days with all extensions.**
- **Debtor cannot assign a lease without providing “adequate assurance” that new lessee will be able to perform on lease and all prepetition defaults must be cured. This includes non-monetary defaults except for penalties.**
- **Contracts containing clauses that automatically terminate the contract in the event of a bankruptcy filing are generally found to be invalid in bankruptcy.**



## LEASES AND EXECUTORY CONTRACTS AND UNEXPIRED LEASES

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# COLLECTIVE BARGAINING AGREEMENTS

- **These are entitled to special treatment such that the Debtor has to:**
  - ❖ *Negotiate the agreement before rejecting the contract.*
  - ❖ *Act in good faith.*
  - ❖ *Make a full disclosure of financial condition.*
  
- **The Bankruptcy Court will only grant a motion to reject the contract if it believes that:**
  - ❖ *There as a good faith effort to renegotiate the contract on the part of the Debtor.*
  - ❖ *The Union rejected the proposed modifications without good cause.*
  - ❖ *When all parties are considered, the decision to reject benefits the most involved.*



## LEASES AND EXECUTORY CONTRACTS AND UNEXPIRED LEASES

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### USE, SALE, OR LEASE OF PROPERTY OF THE ESTATE

- **If in the ordinary course of business, the DIP may enter into a transaction to use, sell, or lease any of the Estate property.**
- **If not in the ordinary course of business, a hearing must be held with notice to creditors.**
- **Property may be sold free and clear of liens and other encumbrances only when:**
  - ❖ *Non-bankruptcy law permits.*
  - ❖ *The lienholders give consent.*
  - ❖ *The sale price is greater than the total value of all the liens against the property, or*
  - ❖ *There is a legitimate dispute over the validity of the liens.*
- **Unless the Court orders otherwise, the lienholder, at any sale, may bid in the amount of its debt.**
  - ❖ A sale according to court order will remain valid even if it is subsequently reversed on appeal, provided the buyer acted in “good faith”.
  - ❖ Most sales are subject to higher or better offers.



***ALTERNATIVES TO  
LIQUIDATING/CLOSING A COMPANY***



## CHAPTER 11

**A Chapter 11 proceeding allows the Debtor to remain in control, but it also exposes the shareholders/officers and Board to extra scrutiny.**

| ADVANTAGES   | DISADVANTAGES   |
|--|---|
| <ul style="list-style-type: none"><li>➤ Automatic stay prevents creditors from taking action.</li><li>➤ Filing provides a mechanism to retain key employees.</li><li>➤ Leases and executory contracts can be assumed or rejected.</li><li>➤ Assets can be sold free and clear of all liens.</li><li>➤ Secured creditors can get super-priority status when providing additional financing.</li><li>➤ Forgiveness of debt is not a taxable event.</li></ul> | <ul style="list-style-type: none"><li>➤ High cost which impairs the Debtor's ability to maximize recovery for the estate.</li><li>➤ 85%+ Chapter 11's are unsuccessful.</li><li>➤ Various interested parties can impact outcome via "irrational" behavior.</li><li>➤ Limited flexibility.</li><li>➤ Time consuming.</li><li>➤ Board/Officers/Shareholders are subject to more scrutiny with regard to insider actions and fraudulent conveyances.</li><li>➤ Creditors' collateral is being liquidated to fund the cost of the bankruptcy.</li></ul> |



## CHAPTER 7

**A Chapter 7 proceeding passes control to a Trustee appointed by the Court, who typically does not maximize the value of the liquidation for the estate.**

| ADVANTAGES   | DISADVANTAGES   |
|--|---|
| <ul style="list-style-type: none"><li>➤ Liquidation begins immediately: business ceases operation and employees are terminated.</li><li>➤ Automatic stay prevents unsecured creditors from taking action.</li><li>➤ Leases and executory contracts can be assumed and assigned or automatically rejected.</li><li>➤ Assets can be sold quickly and free and clear of all liens.</li><li>➤ Cheaper than a Chapter 11.</li></ul> | <ul style="list-style-type: none"><li>➤ Trustee is placed in control by the U.S. Trustee. Trustee is usually appointed from a panel and is usually an attorney with minimal hands-on business acumen.</li><li>➤ Trustee frequently is unfamiliar with business/industry and usually does not have the experience to maximize the value of the assets for the estate.</li><li>➤ Creditors are placing control of the process in the hands of the Court without knowing who will be the Trustee.</li><li>➤ If creditors force into Chapter 7, Debtor may convert to Chapter 11.</li><li>➤ Secured creditors need to get relief from automatic stay.</li><li>➤ Estate lacks cash, so enterprise value rapidly declines.</li><li>➤ If assets are over-encumbered, the Trustee cannot sell them without some benefit to the unsecured creditors.</li></ul> |



## ALTERNATIVES TO BANKRUPTCY

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- *Out of Court Restructuring*
- *Receivership*
- *Assignment for the Benefit of Creditors*
- *Dissolution under State Law*



## OUT OF COURT RESTRUCTURING

**Often times, the most efficient and cost effective solution is to restructure the debts of the Company without Court supervision.**

| ADVANTAGES   | DISADVANTAGES  |
|--|--|
| <ul style="list-style-type: none"><li>➤ Process is very flexible allowing for quick decisions to maximize value of Estate.</li><li>➤ Cost effective.</li><li>➤ No unsecured creditor's committee.</li><li>➤ Flexibility of no court intervention or approvals.</li></ul> | <ul style="list-style-type: none"><li>➤ Leases and executory contracts cannot be assumed or rejected.</li><li>➤ Company can still be thrown into bankruptcy.</li><li>➤ Creditor negotiations are difficult. Each creditor group has its own agenda.</li><li>➤ No court protection.</li></ul> |



## RECEIVERSHIP (STATE AND FEDERAL)

**A Receivership passes control to a Receiver recommended to the Court by the Debtor and other interested parties. The process is very flexible, allowing the Receiver to maximize value to the Estate while being cost effective.**

| ADVANTAGES   | DISADVANTAGES  |
|--|--|
| <ul style="list-style-type: none"><li>➤ Process is very flexible allowing Receiver to make quick decisions to maximize value of Estate.</li><li>➤ Cost effective.</li><li>➤ Allows Creditors to appoint Receiver of choice.</li><li>➤ Provides a transition period which can be beneficial to the creditors and cause less of a negative impact to customers, vendors and employees than bankruptcy.</li><li>➤ No Unsecured Creditor Committee to deal with.</li><li>➤ Stays in some cases may be granted similar to bankruptcy.</li><li>➤ Unsecured Creditors are relatively silent as long as they are informed of the process.</li><li>➤ Do not have to treat all creditors the same.</li></ul> | <ul style="list-style-type: none"><li>➤ Leases and executory contracts cannot be assumed or rejected.</li><li>➤ The presence of liens can create uncertainty in the selling of assets.</li><li>➤ In some jurisdictions, the courts can dictate undesirable restrictions on the receivership process.</li><li>➤ Court appoints a Receiver of its choice, which may differ from the Receiver proposed by the creditors.</li><li>➤ Secured creditor may be required to provide financing.</li><li>➤ No super-priority status is given for new funding without Court approval and then it will be treated as an administrative expense instead of a super-priority lien.</li><li>➤ Receivership does not change tax entity.</li><li>➤ There is no forgiveness of debt provision for tax purposes.</li><li>➤ Company can still be thrown into bankruptcy, but less likely because receivership is Court-supervised.</li></ul> |



## ASSIGNMENT FOR THE BENEFIT CREDITORS

**An Assignment for the Benefit of Creditors is effective when Creditors are in agreement on the distribution of proceeds.**

| ADVANTAGES  | DISADVANTAGES   |
|---|---|
| <ul style="list-style-type: none"><li>➤ Relatively inexpensive versus bankruptcy.</li><li>➤ Relatively quick.</li><li>➤ Less court intervention in the process.</li><li>➤ Quieter process for shareholders.</li></ul> | <ul style="list-style-type: none"><li>➤ Needs to be voluntary on the part of the Debtor.</li><li>➤ Lack of direct court approval creates somewhat higher risk for intermediaries and creditors.</li><li>➤ Higher priority for proper notices and announcements since court approval is not required for asset sales.</li><li>➤ To be most effective, need a cohesive creditor group.</li><li>➤ Typically triggers every default clause of every contract that exists.</li><li>➤ More likely to be thrown into an involuntary because the assignment for the benefit of creditors provides a basis for a bankruptcy order to be filed.</li></ul> |



## DISSOLUTION UNDER STATE LAW

**In certain cases, a simple liquidation may be the best alternative.**

| ADVANTAGES  | DISADVANTAGES   |
|---|---|
| <ul style="list-style-type: none"><li>➤ Board of Directors orders the liquidation of assets and distributions are made according to legal priority.</li><li>➤ Secured lender may choose to conduct a “friendly foreclosure” of its collateral.</li><li>➤ Relatively inexpensive.</li><li>➤ Can be done quickly.</li></ul> | <ul style="list-style-type: none"><li>➤ Creditors leave Officers/Management in control to wind up affairs of business.</li><li>➤ Various interested parties can impact outcome via “irrational” behavior.</li><li>➤ Assets cannot be sold free and clear of all liens.</li><li>➤ Creditors can continue with lawsuits.</li><li>➤ Bulk sales provisions can add complications.</li></ul> |