

BUSINESS BANKRUPTCY
BASICS

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THE CAUSES OF BUSINESS DISTRESS

- Business performance
- Operational issues
- Income issues
- One time events
- Expense issues
- Regulatory issues
- Management issues
- Lender aggression/enforcement

BUSINESS BANKRUPTCY

1. Alternatives to Bankruptcy
2. Life Cycle of Corporate Chapter 7
3. Life Cycle of Corporate Chapter 11

ALTERNATIVES TO BANKRUPTCY

1. Out-of-Court Workout
2. Assignment for Benefit of Creditors
3. Voluntary Receivership

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ALTERNATIVES TO BANKRUPTCY

1. Out-of-Court Workout – Identify Source of the Problem(s)
 - Business performance
 - Operational issues
 - Income issues
 - One-time events
 - Expense issues
 - Regulatory issues
 - Management issues
 - Lender aggression/enforcement

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ALTERNATIVES TO BANKRUPTCY


1. Out-of-Court Workout – Advantages
 - Fewer and lesser transaction costs
 - More private
 - Quicker to implement
 - Less disruptive to operations

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ALTERNATIVES TO BANKRUPTCY

1. Out-of-Court Workout – The Workout Meeting

- Be prepared with accurate and up-to-date financial statements
- Honesty is the best policy
- Lenders' fatigue
- Reestablishing credibility
- One-time occurrences (e.g., a bad winter) vs. patterns of inadequate performance
- Forbearance agreements (consideration and waivers)
- Engage professionals to sell assets
- Engage consultants to turn around operation



ALTERNATIVES TO BANKRUPTCY

2. Assignment for Benefit of Creditors

- The assignment process is the functional equivalent of a liquidation under Chapter 7 of the Bankruptcy Code
- Implemented under common law or a state's statutes
- The assignment of all a debtor's assets is to a trustee for the benefit of creditors
 - Effectively places the assets out of reach of the direct collection efforts of creditors
- No discharge of debts and no ability to reorganize business of debtor

ALTERNATIVES TO BANKRUPTCY

3. Voluntary Receivership

- Similar to assignment for benefit of creditors but involves state court oversight at the outset
- Available in some states (e.g., Wis. Stat. Ch. 128)

BENEFITS OF BANKRUPTCY

- Sell assets free and clear
- Protection for lenders
- Acceptability to professionals/banks
- Automatic stay
- Avoidance powers
- Rejection of unfavorable contracts
- Bind dissenters and unknown claimants
- Possible tax advantages



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BANKRUPTCY DRAWBACKS

- Disruptive to operations
- Long time to implement
- Expensive
- Publicity
- Loss of management control



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CHAPTER 7 BUSINESS BANKRUPTCY

1. Benefits of Chapter 7 Bankruptcy
2. What Must Be Filed
3. Sales vs. Abandonment
4. (No) Discharge

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BENEFITS OF CHAPTER 7 BANKRUPTCY

- Sell assets free and clear
- Protection for lenders
- Acceptability to professionals/banks
- Automatic stay

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WHAT MUST BE FILED

2. Bankruptcy Code § 521(a)(1) and Fed. R. Bank. P. 1007

- Corporate resolutions
- List of creditors
- Schedule of assets and liabilities
- Schedule of current income and expenditures
- Schedule of executory contracts and unexpired leases
- Statement of financial affairs
- Statement of monthly net income

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CREDITORS' MEETING

- Bankruptcy Code § 341(a): Within a reasonable time after the order for relief the United States Trustee shall convene a meeting of creditors
 - Fed. R. Bankr. P. 2003(a) – between 21 and 40 days after filing
 - Fed. R. Bankr. P. 2002(a)(1) – at least 21 days' notice by mail
 - Fed. R. Bankr. P. 4002(b) – documents debtor must bring
 - Fed. R. Bankr. P. 2003(b)(1) – examination of debtor under oath

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SALE V. ABANDONMENT OF ESTATE PROPERTY



3. Sale vs. Abandonment

- Bankruptcy Code § 363(b)(1): The trustee, after notice and a hearing, may sell, other than in the ordinary course of business, property of the estate
 - "after notice and a hearing" means actual notice but an actual hearing only if a party in interest asks (Bankruptcy Code § 102(1))
- Bankruptcy Code § 554(a): The trustee, after notice and a hearing, may abandon property of the estate that is "burdensome" or of "inconsequential value" to the estate
- Bankruptcy Code § 725: The trustee, after notice and a hearing, shall "dispose of" any property to which an entity other than the estate has an interest, such as a lien

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SALE V. ABANDONMENT OF ESTATE PROPERTY

- Bankruptcy Code § 554(a): The trustee, after notice and a hearing, may abandon property of the estate that is "burdensome" or of "inconsequential value" to the estate
 - Fed. R. Bankr. P. 6007
 - (a) Trustee must give notice of a proposed abandonment to all creditors who ordinarily have 14 days of the mailing to ask for a hearing
 - (b) A party in interest may ask the court to order the trustee to abandon property of the estate
 - See Fed. R. Bankr. P. 9006(a)(1) for how to count days

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COSTS OF SALE OF ESTATE PROPERTY

- Who pays the costs of sale?
 - "Over-secured" property: unsecured creditors of estate because costs of sale are administrative expenses (see "Basic Bankruptcy Concepts")
 - "Under-secured" property:
 - ✓ Unsecured creditors of estate, or
 - ✓ Secured creditor if costs "reasonable and necessary" to the extent of benefit to creditor (Bankruptcy Code § 506(c); *Hartford Underwriters Co. v. Union Planters Bank*, 530 U.S. 1 (2000))

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(NO) DISCHARGE

4. Bankruptcy Code § 727(a)(1): Only individuals can get discharge under Chapter 7

- Only individuals may file under Chapter 13 (Bankruptcy Code § 109(e))
- Various entities such as railroads, insurance companies, and banks may *not* be debtors under Chapter 7 (Bankruptcy Code § 109(b))

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LIFE CYCLE OF A BUSINESS IN CHAPTER 11

1. Who are the Players?
2. What Must Be Filed?
3. Rights, Powers, and Duties of a Debtor-in-Possession
4. Cash Collateral and Debtor-in-Possession Financing
5. "First-Day" Orders
6. Sales Outside Ordinary Course of Business
7. Tax Issues
8. Conversion or Dismissal
9. Plan of Reorganization
10. Disclosure Statement
11. Classification of Claims and Voting
12. Confirmation of Plan
13. Cram-Down of Plan
14. Post-Confirmation

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DEALING WITH THE MAJOR PLAYERS

- The Debtor and the DIP
- Committees
- Secured creditors
- Vendors
- Employees
- Independent directors
- The public

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DEALING WITH THE MAJOR PLAYERS

- Claims traders
- The U.S. Trustee
- Customers
- Government entities
- Unions

Why the hallways are larger than the courtrooms (*the importance of negotiation*)

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GETTING THE TEAM ON THE SAME PAGE

- Meeting with employees
- Meeting with vendors
- Meeting with customers
- Meeting with the press
- Meeting with banks
- Hotlines

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PREPACKAGED BANKRUPTCY

- Negotiated and accepted by creditors *before* bankruptcy proceeding commenced



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PRE-NEGOTIATED (OR PRE-ARRANGED) BANKRUPTCY

- Negotiated and accepted by most significant constituencies *before* bankruptcy proceeding commenced
- Solicitation occurs *after* petition filed



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FILING FOR BANKRUPTCY

- Pre-filing planning
- Venue selection
- Petition Packet

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WHAT MUST BE FILED?



1. Bankruptcy Code § 521(a)(1) and Fed. R. Bank. P. 1007
 - List of creditors
 - Schedule of assets and liabilities
 - Schedule of current income and expenditures
 - Schedule of executory contracts and unexpired leases
 - Statement of financial affairs

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WHAT MUST BE FILED

1. What Must Be Filed

- Petition
 - Basic Information
 - "Petition Packet" typically includes:
 - ✓ Petition
 - ✓ Board Resolution
 - ✓ Required Exhibits
 - ✓ List of Creditors
 - ✓ List of Equity Security Holders



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WHAT MUST BE FILED?

- Resolutions of Board of Directors
 - Must authorize appropriate corporate officers to
 - ✓ Sign Necessary Documents
 - ✓ Take Necessary Actions
 - ✓ Obtain Necessary Financing
 - ✓ Engage Professionals



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WHAT MUST BE FILED?

- List of Creditors (Bankruptcy Code § 521(a)(1)(A))
 - Fed. R. Bankruptcy P. 1007(d): Names, address, and claims of 20 largest unsecured creditors *excluding*
 - ✓ Insiders
- List of Equity Security Holders
 - Fed. R. Bankruptcy P. 1007(a)(3): List with names and registered addresses of equity security holders of each class showing number and kind of each interest
 - ✓ Must be filed within 14 days after filing case

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RIGHTS, POWERS, AND DUTIES OF A DEBTOR-IN-POSSESSION

Bankruptcy Code § 1107(a):

DIP has all the rights and powers, and shall perform all the functions and duties of a trustee

- If DIP fails to take seriously its fiduciary obligations, creditors may seek appointment of
 - Independent trustee or examiner (Bankruptcy Code § 1104)
 - Bankruptcy Code § 1106 further specifies duties of independent trustee and examiner

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FIRST-DAY MOTIONS/ORDERS

- Administrative Motions/Orders
- Substantive Motions/Orders
- Additional Case-Specific Motions/Orders
- Comfort Motions/Orders

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SCHEDULES/S.O.F.A EXTENSION

- Schedules of Debtor's Assets/Statement Of Financial Affairs
- Federal Rules of Bankruptcy Procedure, Rule 1007(c)
- Complex Chapter 11 Cases Require Extension
- 30-45 Day Extension Typical

MOTION OF THE DEBTORS FOR ENTRY OF AN ORDER GRANTING
ADDITIONAL TIME WITHIN WHICH TO FILE SCHEDULES AND STATEMENTS

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CASE MANAGEMENT

- Well suited to cases with numerous creditors, counsel, affected parties, etc.
- Allows interested parties to better plan for and attend hearings
- Eases burden on the court
- Saves money for the estate(s)

MOTION FOR ORDER UNDER 11 U.S.C. §§ 102(i) AND 105 AND FED.R. BANKR. P. 2002(a), 9006, 9007 AND 9014 ESTABLISHING (i) OMNIBUS HEARING DATES AND (ii) CERTAIN NOTICE, CASE MANAGEMENT, AND ADMINISTRATIVE PROCEDURES

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APPLICATION FOR EMPLOYMENT OF DEBTOR'S COUNSEL

- Code provides authority for trustee to employ "attorneys, accountants, appraisers, auctioneers or other professionals that are *disinterested persons*"
 - Cannot be a creditor
- Balance fairness to creditors and fairness to professionals
- Newly enacted Rule 6003 governs timing of retention of counsel

APPLICATION BY THE DEBTORS FOR ENTRY OF AN ORDER AUTHORIZING THE EMPLOYMENT AND RETENTION OF MILLER & COLE, LLC AS ATTORNEYS FOR THE DEBTORS

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APPLICATION FOR EMPLOYMENT OF INVESTMENT BANKERS/FINANCIAL ADVISERS

- Qualifications & Expertise
- Services to be Provided
- Disinterestedness
- Indemnification
- § 328 (improvident) or §330 (unreasonable)

APPLICATION PURSUANT TO FED. R. BANKR. P. 2014(a) FOR AN INTERIM ORDER UNDER SECTIONS 327(a) AND 328(a) OF THE BANKRUPTCY CODE AUTHORIZING THE EMPLOYMENT AND RETENTION OF WILSON & ASSOCIATES, LLC AS FINANCIAL ADVISORS AND INVESTMENT BANKERS TO THE DEBTORS

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OTHER PROFESSIONALS

- Corporate Counsel
- Restructuring Consultants
- Public Relations Consultants
- Conflicts Counsel
- Special Counsel (Case-Specific)
- Tax Service Providers
- Crisis Managers
- Notice & Claims Agent

APPLICATION PURSUANT TO FED. R. BANKR. P. 2014(A) FOR AN INTERIM ORDER UNDER SECTIONS 327(A) AND 328(A) OF THE BANKRUPTCY CODE AUTHORIZING THE EMPLOYMENT AND RETENTION OF P/K SERVICES, LP AS CRISIS MANAGERS TO THE DEBTORS

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“ORDINARY COURSE PROFESSIONALS”

- Services and Compensation Procedures
- “Doctrine of Necessity”
- Fee Application requirements are relaxed
- Monthly / Quarterly cap on payments

MOTION OF THE DEBTORS FOR ENTRY OF AN ORDER AUTHORIZING THE DEBTORS TO EMPLOY AND COMPENSATE CERTAIN PROFESSIONALS UTILIZED IN THE ORDINARY COURSE OF THE DEBTORS' BUSINESSES

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TAXES

- “Necessity”
- Ordinary Course of Debtor's Business
- Does not distort priority scheme

MOTION OF THE DEBTORS FOR ENTRY OF AN ORDER (A) AUTHORIZING THE DEBTORS TO PAY PREPETITION SALES, USE AND FRANCHISE TAXES, AS WELL AS FEES, LICENSES AND OTHER SIMILAR CHARGES AND ASSESSMENTS;

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WAGES

- Employees will generally hold unsecured, priority claims
- "Necessity"
- Categorize parties and compensation to be paid
- Statutory cap per employee (\$10,950)

MOTION OF THE DEBTORS FOR ENTRY OF AN ORDER (A) AUTHORIZING THE DEBTORS TO CONTINUE TO PAY AND HONOR CERTAIN PREPETITION CLAIMS FOR (i) WAGES, SALARIES AND OTHER COMPENSATION, (ii) WITHHOLDINGS AND DEDUCTIONS AND (iii) REIMBURSABLE EMPLOYEE EXPENSES; (B) AUTHORIZING THE DEBTORS TO CONTINUE TO PROVIDE EMPLOYEE BENEFITS IN THE ORDINARY COURSE OF BUSINESS; (C) AUTHORIZING THE DEBTORS TO PAY ALL RELATED COSTS AND EXPENSES; AND (D) DIRECTING BANKS TO RECEIVE, HONOR AND PAY ALL CHECKS AND ELECTRONIC PAYMENT REQUESTS RELATED TO THE FOREGOING

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CASH MANAGEMENT/BANK ACCOUNTS

- Chapter 11 Operating Guidelines
- Use existing check stock / honor outstanding checks
- Disruption of Debtor's Business
 - Direct deposit collections (i.e. Healthcare)
- "Business as Usual"

MOTION FOR ORDER AUTHORIZING DEBTORS TO: (i) CONTINUE TO USE EXISTING CASH MANAGEMENT SYSTEM AND BANK ACCOUNTS; (ii) CONTINUE INTERCOMPANY TRANSACTIONS AND PROVIDE ADMINISTRATIVE PRIORITY STATUS TO POSTPETITION INTERCOMPANY CLAIMS; (iii) CONTINUE TO USE EXISTING CHECKS AND BUSINESS FORMS AND (iv) CONTINUE TO USE EXISTING INVESTMENT PRACTICES

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DE MINIMIS ASSET SALES

- Ordinary Course of Business
- Asset sales and abandonment will increase in reorganization
- Parameters and procedures for sales and abandonment

MOTION OF THE DEBTORS FOR ENTRY OF AN ORDER AUTHORIZING AND APPROVING PROCEDURES FOR (A) THE SALE, TRANSFER OR ABANDONMENT OF *DE MINIMIS* ASSETS AND (B) THE SALE OR TRANSFER OF THE ASSETS OF THE NON-DEBTOR SUBSIDIARIES

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UTILITIES

- § 366(a) – 20 days
- Adequate assurance of payment in the form of a deposit or other security
- Court may order reasonable modification of the amount of the deposit or other security necessary to provide adequate assurance of payment

MOTION OF THE DEBTORS FOR INTERIM AND FINAL ORDERS DETERMINING ADEQUATE ASSURANCE OF PAYMENT FOR FUTURE UTILITY SERVICES

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CRITICAL VENDORS

- Continuous service to customers
- Negotiating Leverage
- Most vendors have competitors
- Debtors may be forced to demonstrate:
 - Indispensable nature of vendor's product
 - Form and manner of payment
 - The injury that will be caused to both debtor and vendor if the motion is denied

In re Kmart Corp., 359 F.3d 866 (7th Cir. 2004)

MOTION OF THE DEBTORS, PURSUANT TO SECTIONS 105(A), 363(B), 503(B)(9), AND 546(C)(1) OF THE BANKRUPTCY CODE, FOR AN ORDER AUTHORIZING THEM TO PAY THE PREPETITION CLAIMS OF CERTAIN CRITICAL VENDORS AND ADMINISTRATIVE CLAIMHOLDERS AND GRANTING CERTAIN RELATED RELIEF

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LEASE/PROPERTY REJECTION/ ABANDONMENT

- Maximize Assets
- Identify Leases to Reject/Property to Abandon
- Establish Rejection/Abandonment Procedures
- Rejection is retroactive to the petition date
 - Must perform post-petition / pre-rejection
- May assign contract under certain circumstances

MOTION OF THE DEBTORS FOR ENTRY OF AN ORDER PURSUANT TO SECTIONS 365 AND 554 OF THE BANKRUPTCY CODE AUTHORIZING AND APPROVING EXPEDITED PROCEDURES FOR THE REJECTION OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES OF PERSONAL AND NON-RESIDENTIAL REAL PROPERTY

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CASH COLLATERAL

Bankruptcy Code § 363

- (a) "Cash collateral" means cash, negotiable instruments, securities, deposit accounts, or other cash equivalents in which a creditor has a security interest
- (c) (2) the trustee may *not* use cash collateral *unless*
 - (A) The secured creditor consents, or
 - (B) The court authorizes use after notice and a hearing

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DEBTOR-IN-POSSESSION (DIP) FINANCING

- Continue Existing Credit Relationship
- Convert pre-petition financing to post-petition financing
- § 364
- Emergency Basis
- Budget

AMENDED NOTICE OF FINAL HEARING ON DEBTORS MOTION TO OBTAIN
POST-PETITION FINANCING AND THE USE OF CASH COLLATERAL

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WHAT IS DIP FINANCING?

- The debtor receives a post-petition loan from DIP lenders in exchange for liens and claims against the debtor's assets
- The purpose of DIP financing is to fund the debtor's operations during the chapter 11 case

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WHAT IS DIP FINANCING?

- DIP financing arrangements are often entered into even if the debtor can fund its operations through the use of "cash collateral"
- Provides vendors (and other constituencies) with comfort that the debtor has the means to operate

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WHO PROVIDES DIP FINANCING?

- Pre-petition secured lenders
- New lenders
- Different perspectives

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MEET WITH POTENTIAL DIP LENDERS

- Shop around: statutory standard for approval requires evidence that terms and conditions of DIP financing represent the best deal available
- Negotiate now

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DIP FINANCING PROCEDURES

- Motion to approve financing under §364 and Rule 4001(c)
- Interim Hearing
- Final Hearing Requires 15-days notice. Rule 4001(c)(2). This time cannot be shortened. Rule 9006(c)(2).

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INTERIM AND FINAL APPROVAL

- Interim approval only amount necessary to get to final hearing
- Final approval
- Committee usually involved before final approval

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PRIORITY OF LIENS AND CLAIMS GRANTED AS PART OF DIP FINANCING

- Escalating priorities, intended to assure DIP gets financing on least onerous terms available
 - unsecured administrative priority
 - administrative superpriority
 - lien on unencumbered assets
 - junior lien on encumbered assets
 - *pari passu* lien
 - priming lien

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Bankruptcy Code § 364 order of sources of credit



- (a) The DIP can obtain unsecured credit in the ordinary course *without* permission from the court
- (b) After notice and a hearing, the DIP may obtain unsecured credit outside the ordinary course
- (c) If the DIP can't get unsecured credit, after notice and a hearing it may obtain credit (1) with priority over all administrative expenses, (2) secured by lien on property on which there is no lien, or secured by a junior lien on property
- (d) If the DIP *still* can't get credit, after notice and a hearing it may obtain credit secured by a senior (priming) lien on property if the now subordinated secured creditor is adequately protected

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PRIORITY OF LIENS AND CLAIMS GRANTED AS PART OF DIP FINANCING

- DIP lenders often demand and receive:
 - (1) a lien on all property of the estate not subject to a lien; and
 - (2) a priming lien on all property of the debtor's estate already subject to existing liens

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PRIORITY OF LIENS AND CLAIMS GRANTED AS PART OF DIP FINANCING

- DIP lenders may receive a super-priority administrative claim senior to all administrative claims against the debtor's estate pursuant to §364(c)(1) of the Bankruptcy Code

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TIME PERIOD TO INVESTIGATE LIENS

- DIP Order provides that the debtor is stipulating to the validity and priority of the liens of the DIP lenders/pre-petition secured lenders

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TIME PERIOD TO INVESTIGATE LIENS

- Committee receives a limited time period and possibly a limited budget for investigating the validity and priority of pre-petition secured lender's liens.
- If the committee does not file an adversary proceeding to set aside the liens within this time period, they are deemed valid

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COMMON COMMITTEE/CREDITOR OBJECTIONS TO DIP FINANCING

- Payment of onerous post-petition interest and fees
 - rates are too high
 - too many fees
- Payment of post-petition interest, expenses and fees to pre-petition secured lenders
 - undersecured lenders not entitled to interest, expenses and fees – see §506(b) of the Bankruptcy Code
 - lenders' liens are likely invalid and thus payment of interest and fees is improper at this time

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COMMON COMMITTEE/CREDITOR OBJECTIONS TO DIP FINANCING

- Insufficient time to investigate liens and claims of secured lenders
 - DIP Order stipulates that the liens and claims of the DIP lenders and pre-petition secured lenders are valid and not subject to avoidance or subordination, and the committee gets only a very limited time period and budget to investigate the liens and claims
- Improper roll-over of pre-petition into post-petition debt/cross collateralization

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COMMON COMMITTEE/CREDITOR OBJECTIONS TO DIP FINANCING

- No waiver of §506(c) rights
 - agree to not surcharge secured lender's collateral
- No onerous covenants that make a default likely
 - reasonable cure periods
 - default fees are usually significant
- No "drop-dead" dates for conducting sales or filing a plan, or DIP facility may be terminated

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COMMON COMMITTEE/CREDITOR OBJECTIONS TO DIP FINANCING

- DIP lenders should not assert liens or claims against avoidance actions
- DIP lenders should not get right to compel assumption or assignment of executory contracts
- DIP lenders should not dictate plan terms, other than loan repayment

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ADMINISTRATIVE REQUIREMENTS OF CHAPTER 11

- Filing schedules and statements (and updating)
- §341 meeting
- Monthly operating reports
- U.S. Trustee fees
- Notices and claims administration
- Keeping track of deadlines

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SALES OUTSIDE ORDINARY COURSE OF BUSINESS

Bankruptcy Code § 363(b)(1)

The DIP may use, sell, or lease property of the estate *outside* the ordinary course of business after notice and a hearing

- Sales of DIP's assets are principal purpose of most Chapter 11 cases
- Enables purchasers to acquire assets, or entire enterprises, free of most liabilities without requiring purchasers to participate in the entire bankruptcy case

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ASSET SALES

Sale of Assets in Bankruptcy Through a "363 Sale:" Enables purchasers to acquire assets, or entire enterprises, free of most liabilities without requiring purchasers to participate in the entire bankruptcy case.

Advantages:

- Asset sale generally free and clear of liens, claims and encumbrances
- §363 sale is faster, less expensive, and doesn't require vote of creditors



Disadvantages:

- There is some dispute, and therefore risk to the purchaser, as to whether the court can order the transfer of assets free and clear of certain liabilities, e.g., environmental, product liability, employee claims
- Sub rosa plan argument
- Maybe lose transfer tax exemption
- Does not resolve the whole case

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ASSET SALES

Sale of Assets in Bankruptcy Through a Traditional Plan:
The traditional method for buying and selling assets in bankruptcy has been through the confirmation of the plan. Under certain circumstances, this route may be more advantageous.

<p><i>Advantages:</i></p> <ul style="list-style-type: none"> • Greater structuring flexibility than in a 363 sale • Asset sale generally free and clear of liens, claims and encumbrances • §1146(c) 	<p><i>Disadvantages:</i></p> <ul style="list-style-type: none"> • Stringent confirmation process requirements • Slower, more expensive
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SALES OUTSIDE ORDINARY COURSE OF BUSINESS

Bankruptcy Code § 363(b)(1)

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- Enables purchasers to acquire assets, or entire enterprises, free of most liabilities without requiring purchasers to participate in the entire bankruptcy case

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SALES OUTSIDE ORDINARY COURSE OF BUSINESS

Special Procedure for Small Sales

- Fed. R. Bankr. P. 6004(d): Trustee may give blanket notice of intent to sell all assets when all property of the estate has a gross value of < \$2500

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SECTION 363 SALE PROCEDURES

- Notice and opportunity for a hearing
- Order not required by Code, but parties usually want it
- Special concerns with sale of all assets
- Rule 6004
- Sale free and clear of liens – §363(f)

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SECTION 363 SALE PROCEDURES

- Bidding procedures
- Break-up fees
- Other stalking-horse protections
- Strategy for stalking horse and competing bidder

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COURT APPROVAL OF SECTION 363 SALE

- Satisfying the court
 - adequate marketing
 - adequate disclosure and notice
 - arm's length, non-collusive
- The sale order: What will the court be willing to include?

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FREE AND CLEAR SALES

Bankruptcy Code § 363(f)

The DIP may sell lease property of the estate *free and clear* of all interests of another entity if –

- (1) applicable state law so provides
- (2) other entity consents
- (3)...

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FREE & CLEAR SALES

Bankruptcy Code § 363(f)

The DIP may sell lease property of the estate *free and clear* of all interests of another entity if –

- (3) "such interest is a lien and the price at which such property is to be sold is > the aggregate value of all liens on such property" is ambiguous
 - o sale permitted when purchase price > value of liens on property (In re Collins, 180 B.R. 447 (Bankruptcy E.D. Va. 1995)), or
 - o sale permitted only when purchase price > amount of debts secured by property (Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC), 391 B.R. 25 (B.A.P. 9th Cir. 2005))

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TAX ISSUES IN BANKRUPTCY

- Why are tax issues important?
 - Net operating losses often significant asset of the estate
 - May lose the ability to use NOLS without proper planning
 - Affects post-reorganization cash flow and value
- Involve a tax expert early!
 - Obtain the right advice
 - Gather the right information

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TAX ISSUES IN BANKRUPTCY

- There are two key tax issues in bankruptcy:
 1. Taxation of cancellation of debt ("COD") income
 2. Ability to use "tax attributes"
 - NOLs
 - Capital loss carry forwards

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TAXATION OF COD INCOME

- § 108 – Cancellation of Debt ("COD") income
 - General Rule: If a debt is forgiven, taxable income must be recognized
 - Exceptions:
 - Bankruptcy (Title 11)
 - No current taxable income
 - Out-of-court restructuring
 - Taxable income to the extent that COD makes the taxpayer solvent
 - In both cases, tax attributes are reduced in lieu of the recognition of taxable income

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TAXATION OF COD INCOME

- Reduction of tax attributes
 - Taxpayer reduces its tax attributes as follows:
 - NOLs
 - General business credit
 - Minimum tax credit
 - Capital loss carryovers
 - Tax basis
 - Passive activity loss and credit carryovers
 - Foreign tax credit carryovers
 - However, taxpayer may elect to reduce tax basis first

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ABILITY TO USE TAX ATTRIBUTES

- IRC §382 – Carryover limitations
 - General Rule:
 - A "change in control" leads to a limitation of the ability to use carryovers (IRC §382(a))
 - Annual Limitation = tax-free rate x value of equity

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TAX ISSUES IN BANKRUPTCY

	<u>Bankruptcy</u>	<u>Out-of-court</u>
Cancellation of Debt	No taxable income	Taxable income to the extent that COD makes the taxpayer solvent
Net Operating Losses with Ownership Change	NOL use not limited but reduced for interest <u>or</u> NOL use limited based on value of stock	NOL use limited based on value of stock

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CONVERSION OR DISMISSAL

Bankruptcy Code § 1112

- (a) With some minor exceptions, DIP may convert case under Chapter 11 to one under Chapter 7
 - Typically done after all assets sold under Bankruptcy Code § 363(b)
- (b) (1) on request of a party in interest and after notice and a hearing, court shall either convert case to one under Chapter 7 or dismiss the case "for cause"
 - (2) court may not convert or dismiss if neither is in best interests of creditors and estate and further specific grounds are established
 - (4) lengthy list of specific grounds "for cause" to convert or dismiss

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WHAT'S A PLAN?



- A plan is an agreement between the debtor, its creditors and its equity holders that provides conditions for emergence from bankruptcy, including treatment of their respective claims and interests.
- Can also provide for a sponsored investment, a rights offering or sale
- A contract freely negotiated (sometimes) but approved by a court

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WHEN DOES THE PLAN PROCESS BEGIN?

- Pre-negotiated (Plan w/o votes)
- Pre-packaged (Plan w/ votes)
- In the course of the case
- Out of court restructuring

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DEVELOP THE PLAN CONCEPT

- What is the goal of the plan?
 - Balance sheet restructuring
 - Debt restructure/conversion/refinance
 - Raise new capital
 - Income statement fix
 - Reject unprofitable contracts/leases
 - Rationalize employee benefit/retirement expenses
 - Address operational issues
 - Close locations

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CASH FLOW- THE CORE ISSUE

- The troubled company's cash flow is too small to service debt and pay existing, fixed obligations



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CAN THE PLAN FIX THIS?

- The bankruptcy process seeks to address the troubled company at various points;
- Excess expenses, such as leases, etc. are addressed during the case and may involve rejection of contracts, etc.
- The second part of the case looks to the restructure of the debt

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UNREALISTIC GOALS

- Bankruptcy cannot grow money!
- Can you make the revenues match the new debt service?



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CASH FLOW	
Statement of Cash Flows	
Cash Flow from operations	\$ 10,000
Purchase of fixed assets	\$ (20,000)
Debt service: interest paid	\$ (80,000)
Net cash from operations	\$ (90,000)

REVISED CASH FLOW!!	
Statement of Cash Flows	
Cash Flow from operations	\$ 50,000
Purchase of fixed assets	\$ (20,000)
Debt service: interest paid	\$ (24,000)
net cash from operations	\$ 6,000

THE PLAN OF REORGANIZATION

- Understanding the plan of reorganization: from concept to confirmation



THE PLAN PROCESS

- Structure and devise a business plan
- Negotiate with key constituents
- Create the plan document and disclosure statement
- Obtain approval of disclosure statement
- Solicit votes
- Court confirmation hearing
- Nirvana – the “effective date”

91

DISCLOSURE STATEMENT

Bankruptcy Code § 1125

(b) After debtor has filed bankruptcy, no one, including DIP, may solicit votes in favor of or against plan unless, after notice and a hearing, the court has approved a disclosure statement that contains “adequate information”

- Pre-bankruptcy solicitations (e.g., for a prepackaged plan) are *not* subject to court approval but must still comply with nonbankruptcy law (Bankruptcy Code § 1125(g))

(a) Lengthy provisions regarding “adequate information”

(f) In a “small business case” the court may determine that the plan is sufficient as its own disclosure statement

92

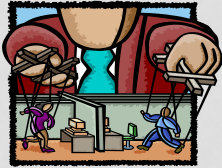
WHAT IS ADEQUATE INFORMATION?

- How and why the company went into bankruptcy
- The business plan: What is the plan for survival after confirmation?
- Cash-flow projections – is the plan feasible?
- How creditors will be treated
- Liquidation options

93

THE POWER TO PROPOSE CONTROL

- The first "tool" is the exclusive right to control the plan process



94

PLAN EXCLUSIVITY

- Section 1121:
 - "Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief."

95

TERMINATION OF EXCLUSIVITY

- Section 1121(d)(1)
 - "Subject to paragraph two on request of a party in interest...the court may for cause reduce or increase the 120-day period...."
- Section 1121(d)(2)
 - (A) "The 120-day period...may not be extended beyond a date that is 18 months after the date of the order for relief...."
 - (B) "The 180-day period [to solicit plan acceptance]...may not be extended beyond a date after the date that is 20 months after the date of the order for relief...."

96

WHAT GOES IN THE PLAN?

- The core elements of a plan include the following:
- Creditors are "classified" into various groups, such as secured and unsecured
- Creditors' claims are then "treated," e.g., provided with new rights under the plan in lieu of existing rights

97

CLASSIFICATION OF CREDITORS

- Section 1122:
 - "[A] plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class."
- Rule- the homogenous class

98

HOMOGENOUS CLASS?

- Classification is like milk
- What's in must be the same
- But must all the skim milk be in **one** bottle?



99

THE JUDICIAL RESPONSE TO GERRYMANDERING

- General Test: "There must be some limit" to what debtors can do
- Courts may permit limited separate classification based on valid business justification



100

TREATMENT OF CLASSES

- Section 1123 (3):
 - "A plan shall . . . specify the treatment of any class of claims or interests that is impaired under the plan"

101

PROPOSED TREATMENT OF CREDITORS

Class	Treatment	Term
Secured	100% of principal	Over 10 years and reduce interest to 4%
Trade	50% of principal	Over 3 years with no interest
Tort	5 % of principal	Over 10 years with no interest

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IMPAIRMENT

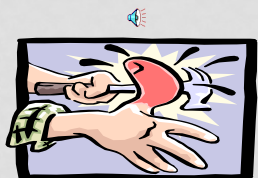


- Section 1124
- [A] class of claims or interests is impaired under a plan unless. . . the plan . . .
 - Leaves unaltered the legal, equitable and contractual rights to which such claim or interest entitles the holders of such claim or interest

103

IMPAIRMENT – THE TICKET TO THE VOTE

- Only impaired classes vote
- Impairment is an alteration of legal rights



104


VOTING – SIGNIFICANCE

- Because creditors vote by class, this means that the majority of creditors can bind the minority
- No state law analog
- A single dissident creditor can block a non-judicial restructure



105

VOTING



- Section 1126:
- A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two thirds in amount and more than one half in number of the allowed claims that [vote]

106

CONFIRMATION STANDARDS

- Section 1129(a) contains 16 separate requirements for confirmation
- At the “confirmation hearing,” the court must determine that each standard is fully satisfied

107

BEST-INTERESTS TEST

- Section 1129(a)(7)
- With respect to each impaired class
 - (i) Each holder of a claim has accepted the plan, OR
 - (ii) will receive or retain on the effective date not less than it would under chapter 7
- Theory: chapter 11 cannot produce worse result than a chapter 7 liquidation

108

LIQUIDATION ANALYSIS

Liquidation Analysis	
Total Assets	\$ 900,000
Admin. Expenses	\$ (100,000)
Secured Creditor	\$ (1,000,000)
Assets for unsecured creditor	\$ (200,000)

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CONFIRMATION STANDARD

- Class acceptance
- Section 1129(a)(8)
 - "With respect to each class of claims or interests –
 - (A) such class has accepted the plan, or
 - (B) is not impaired under the plan

110

CONFIRMATION HEARING

- AND, if there is any class of impaired, non-assenting creditors, then the plan can only be approved under the "cramdown sections of 1129(b)



111

CONFIRMATION STANDARDS - ONE IMPAIRED CLASS

- Section 1129(a)(10)
- If any class of claims is impaired, then at least one impaired, non-insider class must have accepted the plan

112

CONFIRMATION STANDARDS

- Feasibility:
- Section 1129(a)(13): Confirmation of the plan is not likely to be followed by the liquidation of the debtor

113

FEASIBILITY

- The financial test
- Does the debtor have sufficient projected income to service the new obligations. . .
- Or is the new plan merely "terminal euphoria?"



114

DISCRIMINATORY TREATMENT?

Could the plan propose the following:

- all trade creditors: 50% over 2 years.
- all tort claims: 5% over 20 years?
- is this fair?
- is this legal?



115

IS THE PLAN FAIR TO CREDITORS?

To confirm a plan of reorganization you need to demonstrate that creditors receive as much as they would if the business were liquidated (the best interest test)

116

CRAM DOWN

117

CRAM DOWN OF SECURED CREDITORS

- Fair and equitable
- Legal requirements:
 - lender must retain its lien
 - creditor receives deferred cash payments over time which have a present value equal to the value of the collateral



118

CRAM DOWN OF SECURED LENDERS

Lender had first trust of \$1.0 million at 8 % annual interest

- Old note: interest at 8%
- Annual debt service was \$80,000
- The debt service was beyond reach of the debtor



119

NEW SECURED NOTE



- Lender receives new promissory note equal to the value of the collateral – here it is \$600,000
- Interest rate is reset to “market” rate of interest based on expert testimony
- Some key loan provisions may be modified
- New Note: \$600,000 at 4%, which equals \$24,000 per year;
- Savings in debt service of \$56,000!!!

120

CRAM DOWN OF UNSECURED CREDITORS

- Section 1129(b)(2)(B)
- Plan provides that each holder receive or retain **property** [having a] "value . . . equal to the allowed amount of such claim, **OR** . . .
- The holder of any claim or interest that is junior will not receive or retain under the plan on account of such junior claim or interest any property

121

STOCK IN LIEU OF CASH?

- Property or cash equal to the allowed claim
- Creditors may thus become the **owners of the post confirmation business**



122

ABSOLUTE PRIORITY RULE

- The holder of any claim or interest that is junior will not receive or retain under the plan, on account of such junior claim or interest, any property
 - Consent waives this requirement

123

THE NET NET RESULT



- The net result of the absolute priority rule and the best interest rule is. . .
- If the company is insolvent, and if equity holders are to receive nothing, then as long as the unsecured get at least what they would get in liquidation, then the plan may provide for almost any treatment

124

WHAT HAPPENS AFTER THE CHAPTER 11 ENDS?



125

LIMITS OF POST-CONFIRMATION JURISDICTION

- 28 U.S.C. § 1334; effect on distribution
- Substantial consummation and plan modification
- Retention of jurisdiction clauses

126

SUCCESSFUL ENDING

- Reports on consummation of the plan
- Motions for final decree, closing the case
- U.S. Trustee fees

127

PLAN DEFAULT

- Enforcing the plan
- Revocation of the confirmation order – §1144
- Post-confirmation conversion
 - The problem of vesting provisions in the plan, Code
 - What is in the estate?
 - Re-vesting provisions in the plan, conversion order
 - Post-conversion status of plan trusts
 - 28 U.S.C. §1334(e)
 - §348

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BUSINESS BANKRUPTCY PART II

1. Leases and Executory Contracts
2. Where Does All of This Happen: Jurisdiction and Venue
3. Business Bankruptcy Ethics

129

1. LEASES & EXECUTORY CONTRACTS

1. What Is An Executory Contract?
2. What Is A Lease?
3. Assumption or Rejection
4. Timing
5. Rejection: Effects
6. Assumption: Curing and Adequate Assurance of Performance
7. Assumption: Risks
8. Assignment: Power and Benefits
9. Nonassignable Contracts

130

WHAT IS AN EXECUTORY CONTRACT?

Bankruptcy Code § 365(a): The debtor, subject to the court's approval, may assume or reject any *executory contract* ...

- Countryman: "A contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." (mutual "executoriness")
- Others focus on whether debtor—not the counterparty—has duties (other than mere payment of money) remaining under the contract (debtor-only "executoriness")

131

WHAT IS A LEASE?

Bankruptcy Code § 365(a): The trustee, subject to the court's approval, may assume or reject any *unexpired lease* ...

- Lease vs. installment sale/security interest
 - UCC § 1-203—What is the likelihood that the lessor would get back goods with significant remaining economic value?
 - Similar analysis with respect to leases of real estate
- Bankruptcy Code § 365(c): The trustee/DIP may not assume a lease if (3) it is for nonresidential real property *and* has been terminated under state law before bankruptcy filing

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ASSUMPTION OR REJECTION

- The Business Judgment Rule
Scope of judicial review of decision to accept or reject is narrow
Debtor's decision is presumed to be reasonable unless
 - Abuse of discretion, or
 - Bad faith
- Special Cases
 - Rejection of collective bargaining agreements (Bankruptcy Code § 1113)
 - Rejection of contracts pertaining to retiree benefits (Bankruptcy Code § 1114)

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ASSUMPTION OR REJECTION

Hypothetical 1

- Computer Chip Manufacturer and Computer Maker enter into contract. Manufacturer agrees to sell and Maker agrees to buy 10,000 chips per month for 12 months. Maker further agrees to pay \$10,000 for each installment of chips.
- Maker files Chapter 11 six months after contract
 - **Market price of chips has fallen to \$9,000 per 10,000 chips**

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ASSUMPTION OR REJECTION

- ... Maker will reject executory contract with Manufacturer and buy chips it needs on open market
- Manufacturer has a claim for damages in Maker's case as if Maker had breached immediately before filing (Bankruptcy Code § 365 (g)(1))
 - Contract price – market price (UCC § 2-708(1))
 - Contract price – resale price (UCC § 2-706)

135

ASSUMPTION OR REJECTION

Maker files Chapter 11 six months after contract

- **NOW Market price of chips has risen to \$11,000 per 10,000 chips**

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ASSUMPTION OR REJECTION

NOW Market price of chips has risen to \$11,000 per 10,000 chips

- Maker will seek to assume executory contract with Manufacturer:

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ASSUMPTION OR REJECTION

- Procedure FOR ASSUMPTION – Fed. R. Bankr. P. 6006

- (a) Proceeding to assume, reject, or assign governed by Fed. R. Bankruptcy P. 9014
- (c) Notice to other party to contract/lease, parties in interest as directed by court, and U.S. Trustee
- (f) Special rules for "omnibus" motions seeking to assume/reject multiple contracts/leases simultaneously

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ASSUMPTION CONDITIONS

DIP *cannot* assume if there has been a default *unless*

- (A) DIP cures (or provides adequate assurance that it will promptly cure) default
- (B) DIP compensates (or provides adequate assurance that it will promptly compensate) for any actual pecuniary loss due to default
- (C) DIP provides adequate assurance of future performance

139

POWERS & LIMITS ON ASSUMPTION

- DIP has power to assume notwithstanding presence of
- *Ipsa facto* clause in contract/lease (Bankruptcy Code § 365(e)(1))
 - Anti-assignment clause in contract/lease (Bankruptcy Code § 365(c)(1))
 - DIP may not assume a contract that
 - Is to extend credit
 - Has terminated before bankruptcy; however, recall that
 - ✓ Not every breach gives other counterparty power to terminate contract (immaterial vs. material breaches; express conditions subsequent; "law abhors a forfeiture")
 - ✓ Counterparties often waive (expressly or by implication) even material breaches
 - ✓ Contract/lease or governing law may provide for opportunity to cure

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ASSUMPTION OR REJECTION

Timing–Hypothetical 1

- ASSUME Maker will seek to assume executory contract with Manufacturer:

Timing–Bankruptcy Code § 365(d)

- (2) Before confirmation of plan unless court, on the request of the other party, orders DIP to determine whether to assume or reject at an earlier time
- (4) Leases of nonresidential real property are (A) deemed rejected unless assumed before 120 days after filing unless (B) court grants an additional 90 days

141

REJECTION BY LESSEE OF UNEXPIRED LEASE OF REAL PROPERTY

- IF Lessee *rejects* unexpired lease or real property with Lessor
- Lessor has a claim for damages in Lessee's case as if Lessee had breached immediately before filing (Bankruptcy Code § 365 (g)(1))
 - Capped by > one year's rent or 15% of balance of rent due (not exceeding three years' rent)

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ASSUMPTION OR REJECTION

4. Timing-Hypothetical 1

- Maker will seek to assume executory contract with Manufacturer: ~~Waiting~~ Bankruptcy Code § 365(d)
- (3) Must perform all obligations after filing under lease of nonresidential real property (Bankruptcy Code § 365(d)(3))
 - ✓ Court may grant a 60-day "breathing spell"
- (4) Must perform all obligations from 60 days after filing under lease of personal property (Bankruptcy Code § 365(d)(5))
 - ✓ Doesn't apply to individual's lease of consumer goods
 - ✓ Court may order otherwise based on "equities of the case"
- Accruing obligations under contracts and other leases (i) must be paid to cure if assumed or (ii) be treated as administrative expense if rejected

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ASSUMPTION OR REJECTION

5. Rejection Effects

- Does rejection = (only) breach, or
- Does rejection = termination of all interests under contract

Judicial inconsistency so special legislation with regard to:

- Rejection of leases of real property by *landlord* (Bankruptcy Code § 365(h))
- Rejection of contracts for sale of real property by *vendor* (Bankruptcy Code § 365(i))
- Rejection of licenses of intellectual property by *licensor* (Bankruptcy Code § 365(n))

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ASSUMPTION

Curing and Adequate Assurance of Performance

- Maker will seek to assume executory contract with Manufacturer: Curing-Bankruptcy Code § 365(b)(1):
- However, DIP *cannot* assume if there has been a default *unless*
 - (A) DIP cures (or provides adequate assurance that it will promptly cure) default
 - Bankruptcy Code § 365(b)(2): Duty to cure does *not* apply to defaults based on (A) financial condition or (B) filing bankruptcy,

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ASSUMPTION

Curing and Adequate Assurance of Performance

- Manufacturer: ~~Assuring~~ Bankruptcy Code § 365(b)(1)(C)
 - Normally fact-specific
 - Bankruptcy Code § 365(b)(3): special rules for lessees of real property in shopping center

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ASSUMPTION

Risks

With assumption estate has promised to perform in full all of the prepetition debtor's obligations

- Breach or rejection subsequent to assumption generates *administrative expense claim* for damages (Bankruptcy Code §§ 365(g)(2)), 503(b), & 507(a)(2))
- ✓ As of time of rejection (Bankruptcy Code § 365(g)(2)(B)(iii))

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ASSIGNMENT

Powers and Benefits

- Bankruptcy Code § 365(f)(2): Trustee/DIP may assign an executory contract or unexpired lease only if
 - (A) It has been assumed, and
 - (B) Assignee provides adequate assurance of future performance
- Assignment is distinct from assumption; must be evaluated independently
- Assignment operates as a novation—Bankruptcy Code § 365(k): assignment relieves the DIP from any liability or breach after assignment (contra common law and UCC § 2-210(1))

1.48

ASSIGNMENT

Powers and Benefits—Hypothetical 2

- Computer Chip Manufacturer and Computer Maker enter into contract. Manufacturer agrees to sell and Maker agrees to buy 10,000 chips per month for 12 month. Maker further agrees to pay \$10,000 for each installment of chips.
- Maker files Chapter 11 six months after contract
 - Market price of chips has *risen* to \$11,000 per 10,000 chips
 - **Maker no longer plans to make computers**
- Maker will seek to *assume* contract and *assign* it to Newco for agreed-upon amount between \$0 and \$6000

1.49

NON-ASSIGNABLE CONTRACTS

Bankruptcy Code § 365(f):

- (1) Notwithstanding a provision in an executory contract/ unexpired lease, or in *applicable law*, that prohibits an assignment, the trustee/DIP may assign such contract/ lease
 - On its face, permits unfettered power to assign
- But what about Bankruptcy Code § 365(c)? Trustee/ DIP may *not* assume or assign if—(1)(A) *applicable law* excuses counterparty from accepting performance from an entity other than the debtor or DIP
 - Limits assumption/assignment per nonbankruptcy law

1.50

NON-ASSIGNABLE CONTRACTS

- "The Code's language restricting assignments of executory contracts and unexpired leases is nearly incoherent."
- Two sets of interrelated issues:
 - Contractual vs. common law vs. statutory restrictions on assignments
 - Assumption only vs. assumption *and* assignment

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NON-ASSIGNABLE CONTRACTS

- Two sets of interrelated issues:
 - Contractual vs. common law vs. statutory restrictions on assignments
 - ✓ Contractual anti-assignment term unenforceable in bankruptcy
 - ❖ Applied to anti-assignment-"like" terms such as financial conditions on assignment or hyper-restrictive use terms
 - ✓ Common law restrictions on assignment of "personal service" contracts selectively enforced
 - ✓ Statutory restrictions generally enforced
 - ❖ 41 U.S.C. § 6305(a) and various state statutes

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NON-ASSIGNABLE CONTRACTS

- Two sets of interrelated issues
 - Assumption only vs. assumption *and* assignment
 - ✓ Does Bankruptcy Code § 365(c)(1) go so far as to prohibit *DIP* from even assuming contracts that could not ultimately be assigned?
 - ❖ "Actual test:" No (*Institute Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489 (1st Cir. 1997))
 - ❖ "Hypothetical test:" Yes (In re *Catapult Entmt., Inc.*, 165 F.3d 747 (9th Cir. 1999))

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WHERE DOES ALL OF THIS HAPPEN?
JURISDICTION, AUTHORITY AND VENUE

1. Constitutional Background
2. Statutory Middle-Ground
3. Statutory Foreground
4. Venue

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JURISDICTION

1. Constitutional Background
 - Art. III of the Constitution Section 1: The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their offices during good Behavior ...
 - Art. I of the Constitution Section 8, Clauses 4 and 18: The Congress shall have Power To establish uniform Laws on the subject of Bankruptcies ... [and] to make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers ...

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JURISDICTION AND AUTHORITY

2. Statutory Middle-Ground – 28 U.S.C. § 1334
 - (a) Except as provided in subsection (b), the district courts shall have original and exclusive jurisdiction of all cases under title 11.
 - (b) the district courts shall have original but not exclusive jurisdiction of all civil proceedings *arising under* title 11, or *arising in or related to* cases under title 11.

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JURISDICTION AND AUTHORITY

3. Statutory Foreground

- 28 U.S.C. § 151: In each judicial district, the bankruptcy judges shall constitute a *unit of* the district court to be known as the bankruptcy court for that district.
- 28 U.S.C. § 157
 - (a) Each district court may provide that cases *under* title 11 and proceedings *arising under, arising in, or related to* a case under title 11 shall be referred to the bankruptcy judges

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JURISDICTION AND AUTHORITY

3. Statutory Foreground

- 28 U.S.C. § 157
 - (b) (1) Bankruptcy judges may hear and determine all cases *under* title 11 and all "core proceedings" *arising under or arising in* a case under title 11
 - (2) Core proceedings include but are not limited to [list of 16 matters]
 - (5) Personal injury and wrongful death claims are excluded from list of core proceedings and must be tried in the district court

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JURISDICTION AND AUTHORITY

3. Statutory Foreground

- 28 U.S.C. § 157
 - (c) (1) A bankruptcy judge may hear a non-core matter that is nonetheless *related to* the case under title 11 and submit proposed findings of fact and conclusions of law to the district court for entry of any final judgment
 - (d) District court may withdraw any case or proceedings from the bankruptcy judge on its own motion or that of a party in interest

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JURISDICTION AND AUTHORITY

Cases "under title 11"

<u>Proceedings</u> - "arising under"& "arising in"	<u>Proceedings</u> - "related to"
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JURISDICTION AND AUTHORITY

3. Statutory Foreground

- 28 U.S.C. § 158
 - (a) The district court shall have jurisdiction to hear appeals from orders and judgments of the bankruptcy judge in matters referred under 28 U.S.C. § 157
 - (b) The circuit court of appeals may establish a bankruptcy appellate panel (BAP) composed of bankruptcy judges to handle appeals in lieu of appeal to district court
 - (d) Circuit courts of appeals have jurisdiction of appeals from the district court or BAPs

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JURISDICTION AND AUTHORITY

3. Statutory Foreground

- SCOTUS Weighs In: *Stern v. Marshall*, 131 S.Ct. 2594 (2011)
 - Bankruptcy judge does *not* have constitutional authority under Art. III to enter final judgment on debtor's counterclaim against person who had filed a claim in the bankruptcy notwithstanding
 - ✓ Congress's designation of allowance of claims as "core proceeding" (28 U.S.C. § 157(b)(2)(B))
 - ✓ Congress's designation of counterclaim by estate against claimants as "core proceeding" (28 U.S.C. § 157(b)(2)(C))
 - For tactical reasons non-debtor parties frequently seek to withdraw reference to bankruptcy courts in light of constitutional uncertainties caused by *Stern*

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JURISDICTION AND AUTHORITY

3. Statutory Foreground

- SCOTUS Weighs In AGAIN:
- *Executive Benefits Insurance Agency v. Arkison*, 133 S.Ct. 2880 (2014)
- The reasoning of *Stern* constitutionally prohibits a bankruptcy court from entering final judgment on a bankruptcy "related to" claim (non-core). Nevertheless, section 157(c) allows a bankruptcy court to issue proposed findings of fact and conclusions of law to be reviewed *de novo* by a district court.

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JURISDICTION & AUTHORITY

3. Statutory Foreground

- SCOTUS Weighs In AGAIN:
- *Wellness International Network v. Sharif*, 727 F.3d 751 (7th Cir. 2013), *reh'g en banc denied*, (Oct. 7, 2013), *cert granted in part*, 134 S.Ct. 2901 (2014)
- 2 questions certified: (i) whether an action brought against a debtor to determine whether property in the debtor's possession is property of the bankruptcy estate stems from "the bankruptcy itself" or whether such action is outside of the bankruptcy court's constitutional authority to enter a final order, and (ii) whether the parties' consent allows the exercise of Article III judicial power by the bankruptcy courts, and if so, whether implied consent based on the litigant's conduct is sufficient.

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VENUE

4. Venue


- *Bankruptcy Case* – 28 U.S.C. § 1408(1): The district of the debtor's domicile, residence, principal place of business or assets for 180 days before filing or longer portion of such 180 days than anywhere else
- *Bankruptcy Proceedings* – 28 U.S.C. § 1409:
 - (a) In district where case is pending (or anywhere else allowed by general venue statutes), except
 - (b) In "smaller" proceedings only in district where defendant resides

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BUSINESS BANKRUPTCY ETHICS

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State ethics rules do not always fit bankruptcy practice well. Nonetheless, bankruptcy lawyers must comply with State Ethics Rules & Bankruptcy-Specific Ethics Rules.



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TOPICS

- Rule 2014
- Who is your Client and what are your (and your Client's) fiduciary duties?

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RULE 2014

- Details the retention standards set forth in Sections 327 and 1103 of the Bankruptcy Code.
- Purpose of Rule 2014 is to provide the court and the U.S. Trustee with information to determine whether the professional's employment is in the best interest of the estate.
- Rule 2014 requires disclosure of "all the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accounts, the United States trustee, or any person employed in the office of the United States trustee."

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DUTIES OF COUNSEL FOR A DIP AS FIDUCIARY

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Counsel
for DIP



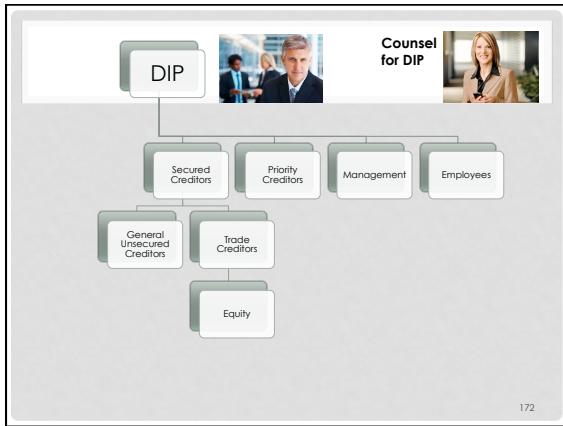
Debtor in
Possession

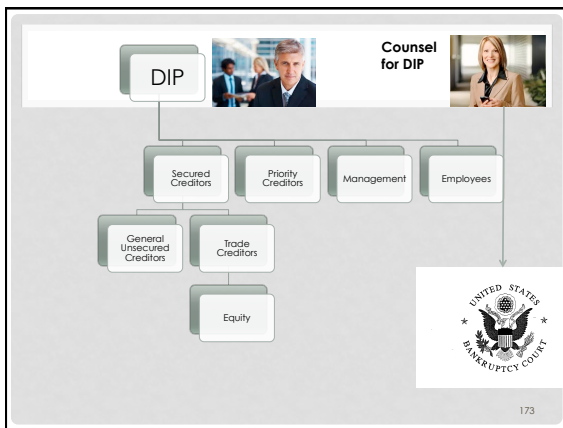


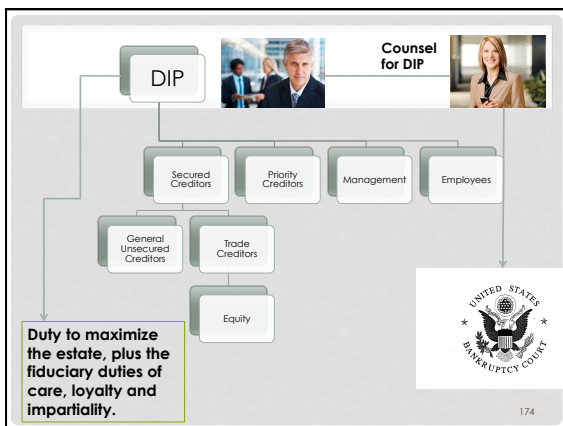
The Estate

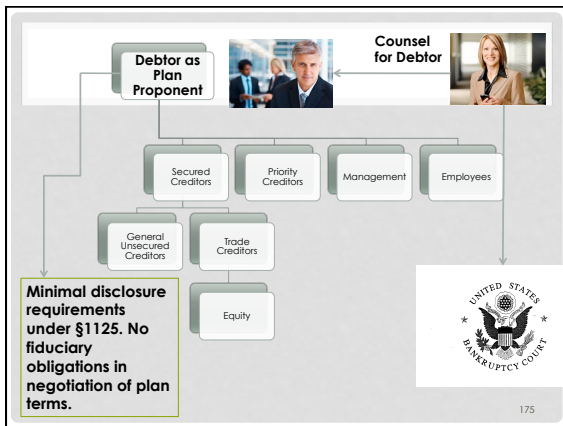


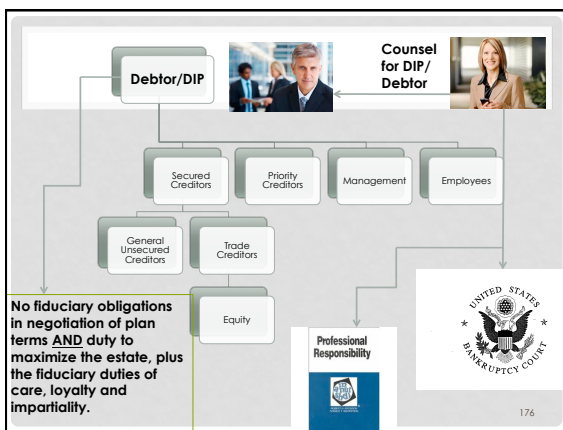
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BEST PRACTICES RECOMMENDATIONS

- A DIP's attorney must be proactive in counseling her client with respect to its compliance with its fiduciary duties to the bankruptcy estate.
- A DIP's attorney must recognize and understand which hat (DIP or Debtor) the client is wearing at a given time. The attorney must reconcile potentially conflicting interests.
- A DIP's attorney must comply with applicable Rules of Professional Responsibility; meet Bankruptcy Code and Rules requirements for disclosure, non-adversity, disinterestedness and reasonable fees and expenses.
- A DIP's attorney must ensure her client knows and understands its basic fiduciary duties to the estate:
 - LOYALTY/CARE/IMPARTIALITY

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