Buchalter

Lions and Tigers and Bears, Oh My!
Insolvency Reality: In and Out of Bankruptcy

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Overview

- Pre-Negotiation Agreements
- Forbearance Agreements
- Where to go when it isn’t going according to plan?
  - —Out-of-court alternatives
  - —Bankruptcy

Pre-Negotiation Agreements

- Substance
  - —No deal until definitive documents are signed and delivered
  - —Any additional reporting
  - —Borrowers and related parties must cooperate
  - —Conditional language

Pre-Negotiation Agreements

- Diligence First
  - —Course of Dealing
  - —Documentation Issues
  - —Perfection Issues
- Tone of Document
  - —Based on results of diligence
  - —Folksy v. Formal

Pre-Negotiation Agreements

- Guiding Principle for all sides:

Hogs Get Fat and Pigs Get Slaughtered
(or vice versa; you know what we mean)

Forbearance Agreements

- Preservation of defaults
- Distinguished from a waiver
- Eye on the prize

Forbearance Agreements

- Primary Components
  - —Recitals: establish the universe of documents
  - —Forbearance: be specific
  - —Modifications: correct any mistakes
  - —Acknowledgements: set up an estoppel
  - —General release

Forbearance Agreements

- Common Features
  - —Budget
  - —Milestones
  - —Very frequent reporting (audit rights?)
  - —Include facts that support relief from stay
  - —Post-default UCC consents/waivers
  - —Post-dispute jury trial waiver

Out-of-Court Workouts

- Why Try an Out-of-Court workout?
  - —There is one clearly “best” path to maximize assets and resolve creditor claims
  - —Assets can be converted into cash more quickly
  - —Administrative costs (read: legal fees) can be substantially lower
  - —If the crown jewel is a melting ice cube asset, may be the best way to maximize value

Out-of-Court | Alternatives

- Several alternatives for out-of-court resolution
  - —Co-ordinated sale of assets with creditor support
  - —An orderly wind down run by the debtor (or a debtor representative)
  - —An ABC-Assignment for the Benefit of Creditors
  - —State Court receivership
  - —Pre-negotiated bankruptcy
  - —Prepackaged bankruptcy (a “pre-pack”)

Out-of-Court Workouts

- Why Isn’t every workout done out-of-court?
  - —Most depend upon two very rare characteristics:
    - Cooperation from the creditor body
    - An honest debtor
- While the actual workout may be quicker, sometimes the constituent groups can dither trying to gain leverage.
- Problems arise when the constituent groups can’t agree on an exit strategy

The Wonderful World of Bankruptcy

- When all else fails, the Bankruptcy Courts
  - —Chapter 7 or 11
    - There are other chapters: 9, 12, 13 and 15
    - “Small Business Debtors”
  - —Debtor must file:
    - Petition
    - Schedules of Assets and Liabilities and
    - Statement of Financial Affairs (the “SOFA”)


STOP

Bankruptcy | Special Events and Deadlines

- 341(a) meeting of creditors
- Claims Bar Date
- Avoidance Actions
- Objections to Discharge

"Reorganization is premised on the concept that the debtor is worth more as a going concern than in liquidation. That is, continuation of the debtor's business will create more value than will dismemberment and piecemeal sale of the assets."

- Frederick Tung, Confirmation and Claims Trading, 90 NW. U. L. REV. 1684, 1689 (1996).

Bankruptcy | Chapter 11 Case Administration

- First Day Motions
- Cash Collateral
- Executory Contracts and Unexpired Leases
- Monthly Operating Reports

Bankruptcy | Chapter 11 Plan of Reorganization

- In chapter 11, the goal is confirmation of a plan of reorganization
  - —The debtor has the exclusive right to propose a plan for the first 120 days, but that time may be shortened (or lengthened, but no longer than 18 months)

Bankruptcy | Chapter 11 Plan of Reorganization

- What is in a plan of reorganization?
- The Plan is the functional equivalent of a contract between the debtor and its creditors.
  - —The Plan puts creditors into classes
  - —Identifies which classes of claims are “impaired”
  - —Specifies treatment of the various classes
  - —Provides “adequate means for the plan’s implementation”

Bankruptcy | Disclosure Statement

- Sort of like a prospectus for a stock purchase
- Court to determine if the disclosure statement contains “adequate information”
- Only after court approval of the disclosure statement can the plan proponent solicit acceptances to the plan

Bankruptcy | Confirmation of a Plan

- Confirmation process
  - —Good faith
  - —At least one class of “impaired” creditors must vote in favor of a plan to move toward confirmation
  - —Each class of impaired claims has accepted the plan (or you go to cramdown)

Bankruptcy | Confirmation Hearing

- "Best interest of creditors" test
  - —Each creditor will receive property of a value that is not less than the amount the creditor would receive in a chapter 7 case. Section 1129(a)(7)(A)(ii)

- "Feasibility" test
  - —Confirmation not likely to be followed by liquidation of further financial reorganization. Section 1129(a)(11)

Bankruptcy | Cramdown

- A plan can be confirmed even if classes of creditors are impaired and do not accept the plan if the plan
  - —Does not discriminate unfairly and is “fair and equitable” with respect to each class of impaired claims that has not accepted the plan

Bankruptcy | Cramdown of Secured Claims

A plan is “fair and equitable”

- As to classes of secured claims, if the creditors
  - —Keep their liens and get a stream of payments of at least the value of the security interest
  - —The collateral is sold free and clear of the creditors’ liens and the liens attach to the proceeds of the sale
  - —Get the “indubitable equivalent” of the claim

Bankruptcy | Cramdown of Unsecured Claims

A plan is “fair and equitable” as to a class of unsecured creditors if the plan provides

- They get paid in full

-or-

- No one junior receives any property on account of the junior claim (the “absolute priority” rule)

Bankruptcy

- What happens if the Chapter 11 case fails?
  - —Chapter 11 trustee
  - —Dismissal
  - —Conversion to Chapter 7

Liquidation

—Any business activity is terminated immediately;

—a Chapter 7 trustee is appointed;

—the debtor says: “here are the keys, I’m outta here;”

—The Chapter 7 trustee

- gathers together all the debtor’s non-exempt assets
- liquids the assets
- Prosecutes claims the debtor may have, and
- makes a theoretical distribution to creditors as their interests lie.

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