



BANKRUPTCY & COMMERCIAL LEGAL PRACTICE

Challenges and Opportunities MCLE



- How To Respond When A Party Adverse To Your Client Files – Or Threatens To File – A Chapter 11 Bankruptcy Case?
- When – If At All – Would A Chapter 11 Bankruptcy Case Make Sense For Your Client?
- Presenters:
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TODAY'S
PRESENTATION



They're In Bankruptcy – Now What?

THEY'RE IN BANKRUPTCY – NOW WHAT?

Whenever Possible, The Best Time To Improve Protection And Mitigate Risk To A Client Arising From An Adverse Party's Bankruptcy Is Prior To The Bankruptcy

Exceptions:

- Gross Mismanagement
- Fraud
- Suspected Embezzlement

May Warrant An Involuntary Bankruptcy Petition

QUICK ASSESSMENT:

- Are There Weaknesses In The Documentation Between Debtor And Client/Creditor Or In Any Inter-creditor Documents?
- Is The Client Party To A Significant Executory Agreement With The Adverse Party?

QUICK ASSESSMENT:

- Will The Debtor Or A Trustee Have Any Defenses Against The Client/Creditor's Claims?
 - Non-Bankruptcy Law Defenses
 - Bankruptcy Code Statutes (e.g., 502(b)(6)'s “Cap” On Lease Damages Claims; 506(b)'s Limits On Accrued Interest)

QUICK ASSESSMENT:

- Has The Client/Creditor Received Transfers Of Money Or Property That May Be Avoidable Under The Applicable Bankruptcy Laws And Thereby Subject To Recovery?
- Do Facts Exist That Will Give Rise To Subordination Or Recharacterization Of The Client/Creditor's Secured Claim?

RISKS TO NON-DEBTORS

- Automatic Stay: *All Litigation Must Cease, Unless The Bankruptcy Court Permits It To Proceed*
- Loss Of Secured Status (Avoidance Of Liens)
- Loss Of Financial Recovery (Through Discharge)
- Subordination, Lender Liability, And/Or Recharacterization
- “Claw-back” Claims (Preferential Transfers, “Actual” Or “Constructively” Fraudulent Transfers)

CLIENT'S OPTIONS – AND PROTECTIONS

Determined By The Client's Non-bankruptcy Relationship To The Debtor

- Holder of a properly perfected Statutory Trust Claim (e.g., PACA/PASA)?
- Consignor?
- Holder of a properly perfected Mechanic's Lien?
- Secured Creditor?
- Seller of Goods (Under UCC-2)?
- Employee?
- Lessor/Licensor/Party to a critical Executory Contract?
- Trade Vendor/Service Provider/Litigant?
- Stockholder/LLC Member

A CREDITOR'S PROTECTIONS

- Statutory Trust (PACA/PASA Creditors)
- Consignment Rights (Was The Seller A “Consignor”?)
- Secured Creditors
 - “Adequate Protection” of Creditor’s Security Interest
 - Use Debtor’s Need For Cash To Extend “Defensive” Financing
 - “Credit Bidding” Rights In Event of an Asset Sale
- Reclamation Rights (Sellers Of Article 2 “Goods”)
 - If Claim Asserted W/In 45 Days Of Receipt Of Goods (+20 Days If 45-Day Period Expires Post-Petition); Otherwise, Administrative Priority Under Section 503(b)(9)

A CREDITOR'S PROTECTIONS

- Priority Wage And Tax Claims
- Litigation Options
 - Motion for Relief From Stay
 - Negotiate Settlement With Chapter 7 Trustee
 - Pursue Non-Dischargeability
- Set-off/Recoupment Rights Against The Debtor
- “Critical Vendor” Of Goods/Services
- “Absolute Priority” Rule, Competing Plan, And Other Confirmation Issues

Does Bankruptcy Make Sense For My Client?



RESET

IS THERE A NEED FOR FINANCIAL RESTRUCTURING?

- **Initial Risk Factors** – Ex. Changes in customer demand, obsolete process or equipment, mounting legacy costs or environmental liabilities, protracted labor disputes, a shifting competitive dynamic within the industry, significant litigation.
- **Cash Shortage** – Ex. Chronic shortages of cash. This can cause a business or public entity to struggle in meeting payroll, debt, or other basic operating obligations.
- **Insolvency** – Ex. Balance sheet and operational insolvency.

WHAT IS THE EXIT STRATEGY?

- Reorganization – Company Could Be Viable With A Change In Capital Structure
 - “Bootstrap” Reorganization
 - Merger
- Sale Of All Or Substantially All Of The Company
- Orderly Liquidation
 - Auction
 - Separate Private Sales

HOW MIGHT A CHAPTER 11 ASSIST THE EXIT STRATEGY?

- Asset Sales Free and Clear of Liens, Claims, and Encumbrances
 - Avoidance of State “Transfer Taxes” Relating to Asset Sales
- “Cramdown” (The Confirmation of a Plan Over The Objection Of Creditors)
- Super-Priority Financing
- Rejection Of Undesirable Leases And Other Contracts
- Issuance Of Securities In A Plan Without Need For Registration Under Federal or State Laws

DOES BANKRUPTCY MAKE SENSE FOR MY CLIENT?

Is Chapter 11 The Best Alternative?

- Is An Out-Of-Court Resolution Possible?
- Will A Chapter 11 Facilitate/Further The Exit Strategy?
 - Sell “Clean” Assets At A Higher Price
 - “Overrule” Dissenting Creditors Who Oppose Restructuring
 - Improve Capital Structure
 - Jettison Undesirable Contracts
 - Eliminate Securities Registration Costs/Transfer Taxes

DOES BANKRUPTCY MAKE SENSE FOR MY CLIENT?

- Is Post-filing Financing Affordable?
- Other Considerations
 - Closely-Held Companies And The “Absolute Priority Rule”
 - Guarantors
 - Debtor “Exclusivity” And Competing Plans
- Do The Benefits Justify The Administrative Cost?
 - Will There Be A Creditors’ Committee?
 - “Small Business” - < \$2m In Undisputed, Non-insider Debt (Secured And Unsecured)?

QUESTIONS?