

Getting to the Front of the Line – What to Do When Your Debtor Declares Bankruptcy

August 22, 2013

“All animals are equal, but some animals are more equal than others” George Orwell, Animal Farm

Edward H. Arnold, III

Jan M. Hayden

Baker Donelson

Bankruptcy Chapter and Verse

- Chapter 7 – Business and Individual Liquidation
- Chapter 9 – Adjustment of Debts of a Municipality
- Chapter 11 – Business and Individual Reorganization
- Chapter 12 – Adjustment of Debts of Family Farmers and Family Fisherman
- Chapter 13 - Adjustment of Debts of Individuals with Regular income
- Chapter 22 – Chapter 11 of a Previous Chapter 11 Debtor

Bankruptcy: The Good, The Bad and The Ugly

(Bankruptcy is not always bad)

The Bankruptcy Code, 11 U.S.C. § §101 et seq.

- GOALS

1. Temporary Relief from Creditors
2. Equitable Distribution of Assets
3. A “Fresh” Start

- TOOLS

1. The Automatic Stay of 11 U.S.C. §362
2. The Creation of an Estate 11 U.S.C. §541
3. Discharge of Indebtedness through Discharge Order or a confirmed Plan

- RESULTS

1. Right to Repossess Converted to Right to Recoverable Value
2. Distribution Waterfall Pursuant to Bankruptcy Code
3. Clean Balance Sheet for Reorganized Debtor

The Rules of the Game

1. The Bankruptcy Code
2. The Bankruptcy Rules
3. The Official Forms
4. The Local Rules
5. The Federal Rules of Civil Procedure
6. Applicable State Law

The Players

1. The Bankruptcy Judge
2. The Debtor in Possession/Trustee
3. The Office of the United States Trustee
4. The Creditors Committee
5. Accountants, Turnaround Consultants, Financial Advisors, Experts
6. The Liquidation Trust/Trustee
7. Attorneys

Potential Advantages of Bankruptcy:

- Differences in Creditors' Rights under State Law vs. Bankruptcy Law.
 - Example: No Landlord's Liens
- Focus in Bankruptcy on Equality of Treatment of Similarly Situated Creditors.
 - Recovery Possible for Preferences
- Information Available In Bankruptcy (PACER)
- Structured System

-
- Commercial Bankruptcy Basics

Chapter 11 Bankruptcy Timeline

- Commencement by filing of Chapter 11 Petition for Relief
 - Voluntary
 - Involuntary (3 or more creditors whose net, undisputed claims exceed \$13,475, 11 U.S.C. §303)
- Automatic Stay of 11 U.S.C. §362
- First Day Motions
 - Retention of Counsel and Professionals
 - Compensation of Insiders
 - Pay employees wages, insurance and benefits
 - Pay critical vendors
 - Utility deposits
 - Borrow money and use cash collateral
 - Budget – 13 week cash flow, CASH IS KING

-
- Filing of Statements and Schedules
 - 341 Meeting
 - Formation of Creditors' Committee
 - Proof of Claim
 - Stabilization and Reorganization
 - Executory Contracts and Leases, 11 U.S.C. §365
 - Sale of Assets, 11 U.S.C. §363
 - Preference and Fraudulent Conveyance Action
 - Adversary Proceedings
 - Monthly Operating Reports
 - Disclosure Statement
 - Plan of Reorganization
 - Confirmation Hearing
 - Post-confirmation cleanup

Chapter 7 Timeline

- Commences same as Chapter 11
- Same Automatic Stay
- 341 Meeting
- Possible to Elect a Trustee
- Administration v. Abandonment

All Creditors Are Not Treated the Same

Secured vs. Unsecured

- Rights – Example: Foreclosure vs. Phone Call, Nasty Letter or Lawsuit
- Key Factor in How You Look at Bankruptcy Issues
- Constant Tension Between Rights of Secured vs. Unsecured Creditors
- Special Protection Afforded by lien, guaranty, letter of credit, etc.

Special Situations:

- Leases & Certain Types of Contracts
- Reclamation Rights
- Setoff
- Letters of Credit
- Priority claims including § 503(b)(9) claims

Priority Claims

- Administrative Claims (11 U.S.C. §503)
- Employee Wages and Benefits (11 U.S.C. §507) up to \$11,725 per individual for wages earned within 180 days; benefits priority calculated using \$11,725 minus payments of wage claims
- Taxes
- Misc. others including deposits, DWI claims

-
- Administrative Claims are unsecured claims incurred as the actual necessary costs and expenses of preserving the estate
 - 11 U.S.C. §503(b)(9) – Administrative claim for goods received within 20 days of commencement that were sold in the ordinary course. This is in addition to any right to reclamation
 - Note having the administrative priority does not mean you get paid, may still need to request payment under §503(a)
 - Debtor may file motion establishing “procedures” for handling §503(b)(9) claims, be wary of deadlines set in procedures for asserting claims or provisions that delay payment until plan confirmation

Reclamation

- Right to reclaim goods is preserved if goods were received while the debtor was insolvent within 45 days of the commencement of case
- Notice must be given in 45 days or within 20 days if the 45 days expires after commencement of case
- Note this is in addition to the rights that may be concurrent under 503(b)(9)
- Same warning re: Debtor's procedural motion

Set Off

- Set Off or Compensation as known in Louisiana allows an otherwise unsecured creditor to “collect” claims by setting it off against claims owed to debtor
- Must be mutual debts – careful re: pre petition against post petition

Leases of Personal Property and Equipment

- In Chapter 7 must be assumed/rejected within 60 days
- In Chapter 11 can assume or reject up to Plan – although creditor can shorten the period
- Be careful Plan can set cure terms and amounts
- Debtor or Trustee to timely perform post petition from or after 60 days from order for relief unless Court orders otherwise – so get your post petition rent!
- Like real estate leases entitled to cure payments and adequate assurance of future performance

Modifications to the Treatment of Leases and Executory Contracts in BAPCPA

- 11 U.S.C. §365(d)(4) – 210 day limit on the decision to accept or reject an unexpired lease of nonresidential real property absent consent of landlord
- Landlords are entitled to answer as to whether Debtor or Trustee will assume lease of non-residential real property within 210 days
- If lease is assumed, entitled to adequate assurance of future performance in addition to cure of defaults
- If rejected, get damage claim subject to the limits of §503
- Note if Debtor is the landlord, Debtor has little motivation to reject
- Limitation in §503 to damages arising out of rejected employment contracts

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)

- 11 U.S.C. §1121(d) – Extension of Debtor’s initial exclusive period of 120 days to propose a plan limited to 18 months from the filing date

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)

- Small Business Bankruptcy exclusive period is 180 days but plan and disclosure must be filed in 300 days

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)

- Trustee or Debtor must bring actions to recover preferences of less (currently less than \$12,475) from non-insiders in the defendant’s district

-
- Modifications to Preference Actions
 - 11 U.S.C. §547(c)(9) – Eliminates by definition commercial small preferences (currently \$5,850)

-
- 11 U.S.C. §547(c)(2) – Eliminates conjunctive “and” reducing creditor burden

(c) The Trustee may not avoid under this section a transfer –

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was –

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms.

-
- 11 U.S.C. §362(d)(3)(B) – Allows stay relief if Single Asset Real Estate debtor does not commence interest payment at non-default rate within 90 days

Take Advantage of Available Information

Information Available

- Statements and Schedules
- Section 341 Meeting
- Monthly Reports
- Creditors' Committee
 - Note BAPCPA added Section 1102 (b)(3) provides that committee is to provide information to the unsecured creditors on case
 - Committee may decide to establish Website and should respond to requests for information

File Your Claim- Most of the Time

Proof of Claim Issues

- Who must file a Proof of Claim and when?
 - Chapter 7, 12 and 13 – All creditors must file Proof of Claim no later than 90 days after the initial date of the 341 meeting. 11 U.S.C. §501, BR 3002.
 - Chapter 11 – Creditors not listed in the statements and schedules or listed as disputed, contingent or unliquidated 11 U.S.C. §1111(a), BR 3003(c)(2). Deadline set by Bankruptcy Court usually pursuant to a Motion to Set Bar Date.
- What documentation must be included with a Proof of Claim
 - Official Form 10 and instruction
- U.S. Trustee Proof of Claim Initiative

Guidelines for Reviewing Mortgage Proofs of Claim

The Bankruptcy Code requires standing trustees to examine proofs of claim and object to the allowance of any claim that is improper if a purpose would be served. This duty pertains to all judicial districts, even districts in which local rules or practices expressly provide that debtor's counsel are required to review proofs of claim as part of the representation of their client. If a specific provision of these guidelines conflicts with a local rule, administrative order, or case law, the local rule, administrative order, or case law will control.

For claims secured by a lien on the debtor's residence that are to be paid by the trustee under the plan the trustee must, at a minimum:

-
1. Verify that copies of documents supporting a perfected security interest are attached to the proof of claim. If the secured creditor/mortgagee fails to attach copies of documents supporting a perfected security interest and the trustee is unable to confirm that the creditor/mortgagee has perfected its security interest, the trustee must take appropriate action.
 2. Verify that there is an itemization of the pre-petition fees, costs, and other charges attached to the proof of claim. If the proof of claim does not include an itemization of the fees, costs, and other charges and the trustee is unable to obtain the itemization, the trustee must take appropriate action.
 3. Verify whether the proof of claim includes a flat fee for review of the chapter 13 plan prior to confirmation and for preparation of the proof of claim and, if so, whether the fee is reasonable and fairly reflects the attorneys fee incurred. If the trustee determines that the fee is not reasonable, the trustee must object to the claim or take such other action as may be appropriate.

-
4. Verify that the secured creditor has filed a proof of claim. If no claim has been filed, the trustee must ensure that the mortgagee's claim is not paid or take other action as may be appropriate.
 5. If a trustee determines, based on the trustee's facial review of the mortgage proof of claim, that the fees, costs, or charges are material and improper, the trustee must take appropriate action.

TRADING CLAIMS

- Do I want to sell my claim?
- Read the Agreement.
- What happens if a preference action is filed after my claim is sold?

What Should Happen

Chapter 7

- Secured Creditor Gets:
 - Value of Collateral
- Unsecured Creditors Get:
 - Pro Rata Percentage of Trustee Recovery

Chapter 11

- Secured Creditor Gets:
 - The Collateral or Value Thereof
 - Fair Market Interest Rate
 - Reasonable Amortization
- Unsecured Creditors Get:
 - At Least As Much As In A Chapter 7
 - Equity Holders (Owners) May Not Keep Ownership Interest (But There Are Exceptions)

Chapter 13

- Secured Creditor Gets:
 - Value of Collateral
 - Fair Market Interest Rate
 - Reasonable Amortization
- Unsecured Creditors Get
 - Pro Rata Percentage of debtor's disposable income for life of Plan (5 years)

“The bankruptcy court is a little like a soup kitchen, ladling out whatever is available in ratable portions to those standing in line. Nonetheless, scarcity begets innovation in the hungry creditor’s quest to get a little more than the next fellow.”

From XL/DataComp, Inc. v. Wilson (In re Omegas Group, Inc.), 24 BCD 413 (6th Cir. 1994) (Judge Batchelder)

Recent Trends and Cases

-
- “The Bankruptcy court is a little like a soup kitchen, lading out whatever is available in ratable portions to those standing in line. Nonetheless, scarcity begets innovation in the hungry creditor’s quest to get a little more than the next fellow.”

From XL/DataComp, Inc. v. Wilson (In re Omegas Group, Inc.), 24 BCD 413 (6th Cir. 1994) (Judge Batchelder)

Upcoming Webinar

October 03, 2013

Minimizing Litigation Risks Arising Out of Dodd-Frank

650+ Attorneys and Advisors in 18 Offices

