

Corporate Reorganizations Under US Law

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1. Theory

- 2 competing policies
 - **i) equity** – equal sharing of losses by CR of equal rank
 - ⇒ **preservation of assets** – prevent “race to courthouse” to preserve assets for estate / all CR + avoiding powers + auto stay
 - **ii) reorganization** – restructuring of business to maximize recovery to all parties
 - ⇒ **facilitating negotiation** / compromise / settlement b/w parties by promoting communication / limiting restrictions thereon (~ CR committee)
 - ⇒ **fresh start** – company should emerge from bankruptcy w/o pre-petition burdens
 - ⇒ **preservation of assets** – see above
 - ⇒ **consider** – CR lend based on going concern value
- Interpretational issues – look to plain language of stat
- Priority of claims – make sure expenses of bankruptcy are paid so as to ensure that competent professionals will want to participate
- Judicial Review of Plan - is it reasonably possible that complaining party would get less in litigation - **Barry v. Smith**

2. General Issues

- **A) Alternatives to Business Failure**
 - **i) Asset Sales** -
 - **ii) Refinancing** -
 - **iii) Out of Court Restructuring** -
- **B) Identify what caused bankruptcy**
- **C) Valuation Issues**
 - **i) methodologies** –
 - **a) Comparable Companies** – trading values of firms inn same industry
 - ⇒ **assumes** - **(i)** expected future C/F grow at a constant rate / w/ same risk + **(ii)** company value varies in direct proportion w/ changes in the performance measure used
 - ⇒ **benes** - if assumptions correct → w/b more accurate than DCF (b/c DCF incorporates contemporaneous market expectations)
 - ⇒ **cons** - **(i)** companies are never perfectly comparable + **(ii)** no clear method for choosing the performance measure
 - **b) Comparable Transactions** - multiples of companies involved in similar tranactions
 - **c) DCF** -
 - ⇒ **WACC** - not relevant b/c assumes constant D/E ratio

⇒ **Adjusted Present Value (APV)** = (i) value of firm as an unlevered / all equity firm + (ii)

⇒ **bene** - tailored to specific firm being valued

⇒ **con** - depends on accuracy of C/F and risk measures

➤ **d) Implied Purchase Price** –

➤ **e) capitalized earnings** ~ avg earnings / IRR

➤ **f) appraisal value / replacement cost** -

➤ **g) market value** -

- **ii) situations** -

➤ **a) Reorganization Value** –

⇒ **when** ~ valuing claims to determine who participates in Reorg = Total Enterprise Value (TEV)

⇒ **method** ~ should take account of future activity

➤ **b) lift stay motions** – determining adequate protection and extent of collateral margin – **American Kitchens**

➤ **c) Debtor tries to cramdown** – “Replacement” value **Rash** excluding any improvements / non CR added features (text)

⇒ weakness of replacement value = m/b litigated (<> looked up)

- **iii) judicial standard of review** ~ range of reasonableness - in reviewing the terms used in a consensual plan of reorg court considers whether the terms fall w/i a range of reasonableness – **Barry v. Smith** (2nd 1980)

• **D) Securities registration** -

- **i) applies when** – corp **either (i)** issues new securities in reorganization **or (ii)** asks security holders to modify rights (~ SEC views as a “deemed exchange”)

- **ii) requires** – corp must **either (i)** file registration stmt **or (ii)** find applicable exemption

• **E) Substantive Consolidation**

- **Applies where** – either of two tests are met

➤ **a) Elements test** – consider whether - Parent owns all / majority of C/S of Sub + P / S have common D & O + P finances S + P is responsible for incorporation of S + S has grossly inadequate capital + P pays salaries / exp / losses + S has substantially no business except

➤ **b) Balancing Test** (**Augie Restivo**)

⇒ **1)** whether CR dealt w/ entities as a single econ unit and did not rely on their separate identity in extending credit

⇒ **2)** whether affairs of the Debtors are so entangled that consolidation will benefit all CR

• **F) Equitable Mootness / Claim Preclusion**

- **i) equitable mootness** –

➤ **applies if** – implementation of requested relief = inequitable

➤ **consider whether (i)** Plan substantially consummated / stayed + **(ii)** requested relief affects rights of others OR success of Plan + **(iii)** public policy of affording finality to bankruptcy judgment + (iv) whether affected party w/b deprived of day in court

- **ii) claim preclusion** –
 - **applies if** – (i) final judgment (ii) on the merits (iii) in prior suit involving same parties (iv) current suit is based on same COA
 - **e.g.**, - where party fails to make timely claim / appeal

3. Filing

- **A) Deciding whether to file**

- **i) Consensual restructuring** –
 - **benes** – maintain confidence of critical partners (trade CR, EEs, public) + indicates positive view of company's future + limits disclosure / maintains confidentiality + faster than Ch. 11 + flexibility of private business dealings + better chance that equity retains some interest
 - **cons** – slow + differences may exist as to what caused problem + Debtor bears cost of restructuring alone + less leverage in negotiating w/ CR (~ no auto stay / exclusivity period) + requires all CR agree (~ no cramdown ability) + may be less tax favored (debt forgiveness = income) + no exemption from federal securities laws
- **ii) Ch. 11 reorg**
 - **benes** - Bankruptcy case may aid in valuing company + Debtor has some leverage over CR + no income from cancellation of indebtedness (IRC § 108(a) – BUT it must reduce tax attributes by amount of such forgiveness) + automatic stay + mgmt usually stays in power (unless Trustee appointed) + rejection of executory K + cramdown of financial structure
 - **cons** - Substantial costs / delay (mitigated by pre-packaged bankruptcy) + Debtor concedes substantial authority over ops + Mgmt role / duties may be confused + complying w/ Code deadlines / mandates may distract mgmt more + extensive public scrutiny during process + negative press at filing + CR has right to examine Debtor execs under oath (w/i 40 days of initial filing) + must include all CR + parties in interest may litigate to improve their priority position
- **iii) Prepackaged Plan** – Debtor negotiates Plan / solicits approval before filing petition
- **iv) Pre-negotiated Plan** – Debtor negotiates Plan + Files Plan + solicits Plan approval after court approves disclosure stmt

- **B-1) Jurisdiction (of bankruptcy court) –**

- **i) Constitutional authority** – Art I, § 8, Clause 4 – grants Congress power to adopt uniform laws of bankruptcy
- **ii) Constitutional Limits** (of B/C jurisdiction under Bankruptcy Reform Act) – Only full, life tenured Art III judges may rule on issues remote from Bankruptcy – **Marathon Pipeline** – *US 1982 – invalidated as unconstitutional the granting of broad jurisdiction to B/J*
 - **Concern** = Federalism (~ ability of bankruptcy judges to rule on matters of state law)
- **iii) Bankruptcy Amendments and Federal Judgeship Act (BAFJA) Goal** – jurisdiction granted to district court w/ delegation to Bankruptcy Court
- **iv) Types of Bankruptcy Jurisdiction** – § 1334
 - **Exclusive B/C jurisdiction** – requires that bankruptcy case be filed in the **proper** federal court
 - ⇒ **i)** cases under Title 11
 - ⇒ **ii)** property of debtor
 - ⇒ **iii)** property of estate

- **Original (not exclusive)** – civil actions may be filed in any number of other courts w/ original jurisdiction (but note effect of Auto Stay)
 - ⇒ **iv)** arising in – matters determined under the B/C
 - ⇒ **v)** arising under – non-bankruptcy matters that come up in bankruptcy proceedings
 - ⇒ **vi)** related to – matters O/S bankruptcy (at least initially)
- **v) Reach of jurisdiction** = nationwide
- **vi) Jury trials** – filing of claim waives right to jury trial – **Granfinanciera v. Nordberg** – US 1989
- **vii) Abstention** (§ 1334(c)) – B/C may **unreviewably** (§ 1334(d)) abstain from hearing matters -
 - **permissive / discretionary** - matters which “arise in / under” or “relate to” Bankruptcy unless constitute part of bankruptcy case itself (~ b/c part of B/C exclusive jurisdiction)
 - **mandatory** – IF all of **(i)** party to the proceeding makes timely motion + **(ii)** matter is “related to” + **(iii)** only federal jurisdictional basis is Bankruptcy Code + **(iv)** separate action h/b commenced in state / appropriate jurisdiction + **(v)** other action c/b timely adjudicated
 - ⇒ **exception** = **personally injury / wrongful death claims** - liquidation / estimation of contingent / unliquidated personal injury / wrongful death claims against estate (§ 157(b)(4) ~> **a federal D/C** must estimate dmgs w/o sending claim back to state court
 - ❖ **a federal D/C** – D/C (of bankruptcy) chooses either **(i)** the D/C (of bankruptcy) **or** **(ii)** D/C where claim arose
- **viii) D/C Review of B/C Decision** -
 - **Normal review** – B/C findings treated as D/C findings of fact re: either **(i)** bankruptcy matters **or** **(ii) core proceeding** arising under / in bankruptcy **or** **(iii) non-core proceedings** if all parties consent to B/J review (some courts say includes “related to” matters (**but** – this may violate **Marathon** b/c allows B/J to hear state law matters))
 - ⇒ **core proceeding** -
 - ❖ **generally** - issues that fundamentally involve bankruptcy law / mgmt of estate (~ any other law is only secondary)
 - ❖ **includes** (§ 157) – admin of estate + allowance of claims + T/O orders + exercising avoidance powers + objections to discharge + determining extent / validity / priority of liens + auto stay litigation + plan confirmation + use / sale / lease of prop
 - ❖ **excludes** – liquidation / estimation of contingent / unliquidated personal injury / wrongful death claims against estate (§ 1332)
 - ⇒ **non-core proceedings** – anything not a core proceeding
 - ❖ **no jury trial possible** – in B Crt b/c of (i) Constitution prevents re-examination of fact on appeal from jury trial + (ii) D/C exercises de novo review of B Crt proceedings
 - **De novo review** (B/J ~ magistrate) – matters merely **related to** Bankruptcy case
 - ⇒ **related to** - matters O/S bankruptcy (at least initially)

• B-2) Venue

- **Initial filing** – 28 USC § 1408 –
 - **generally** = district where Debtors principal place of business / assets located in US for proceeding 180 days (or the longer portion of such 180 day period than anywhere else)

- **exceptions** –
 - ⇒ **1) affiliate filing** - if pending case of Debtor affiliate → Debtor may file in affiliates jurisdiction (not mandatory)
 - ⇒ **2) forum non-conveniens** – court may allow “in interest of justice or for convenience of parties” – 28 USC § 1412
- **wrong venue** – remedy = transfer <> dismissal
- Factors for Debtor to consider – sophistication of bar / judiciary + avoiding angry EE's + file over weekend to avoid transactions in process

• C) Choosing a Chapter

- **i) Ch. 7 Liquidation**
- **ii) Ch. 11 Reorganization**
 - **available to** – businesses + purely consumer debtors
 - **requires** – petitioner must show reasonable possibility of reorg (but NOT a viable plan of reorg) – **In re Bermec Corp** (2nd 1971) – *most CR claim that will reject any plan of reorg of DR truck leasing company*
 - **pros** – saves companies / jobs (~ better protects non-creditor constituencies) + preserves going concern value (to benefit of all constituencies)
 - **cons** – moral hazards (effect of protection against loss on risk taking) + over-incentive to mgmt to pursue reorg + subject to abuse by attys (allows greater fees than Ch. 7 / 13) + limited creditor power + system views reorg as success / liquidation as failure
 - **goal** – present assets retained + current debts repaid from future income
- **iii) Ch. 12** –
- **iv) Ch. 13** –

• D-1) Conversion / dismissal – § 1112

- **i) general limits** – on conversion → no conversion allowed -
 - **a)** to any Chapter for which Debtor not eligible
 - **b)** to evade limits on involuntary filings
 - **c)** to Ch. 12 / 13 **IF** Debtor received Ch. 11 discharge
 - **d)** to Ch. 12 **unless** conversion is “equitable”
- **ii) voluntary conversion** -
 - **generally** – Debtor has absolute right to convert to Ch. 7 liquidation (b/c difficult to reorg w/o Debtor help)
 - **exceptions** -
 - ⇒ **1)** Debtor <> DiP **OR**
 - ⇒ **2)** reorg = involuntary **OR**
 - ⇒ **3)** case converted to Ch. 11 on motion of party other than Debtor
- **iii) involuntary conversion / dismissal** – motion may be made by any Party in Interest or US Trustee
 - **a) involuntary conversion** – allowed if both -
 - ⇒ **1) notice + opportunity t/b heard occurs** **AND**
 - ⇒ **2) for cause** – includes any of following
 - ❖ **i)** loss continuation / diminution of estate + no reasonable possibility of rehab
 - ❖ **ii)** inability to effectuate a plan

- ❖ **iii)** unreasonable Debtor delay prejudicial to creditors
- ❖ **iv)** failure to propose plan w/i deadlines – BUT court often extends deadline
- ❖ **v)** court denies both **(i)** confirmation of all proposed plans + **(ii)** request for time extensions
- ❖ **vi)** court **(i)** revokes confirmation + **(ii)** denies confirmation of other plan (~Debtor misconduct)
- ❖ **vii)** inability to effect **substantially consummation** of plan
 - ↳ **substantially consummation** = all of **(i)** transfer of substantially all property that plan proposes to transfer **AND (ii)** assumption by Debtor / successor of business / mgmt of substantially all property dealt w/ by plan **AND (iii)** commencement of plan distributions
- ❖ **viii)** material default of plan by Debtor
- ❖ **ix)** termination of plan by own terms
- ❖ **x)** failure to pay required fees

➤ **b) dismissal** – allowed if either –

⇒ **1)** both - **(i) notice / opp t/b heard and (ii) for cause** (see (2) above) **OR**

⇒ **2)** filing made in **bad faith** – C/L development

❖ **bad faith** – courts disagree as to standard (subjective = 11th ; objective = 4th)

❖ common in – non-traditional, specialized types of proceedings (~ products liability cases)

• **D-2) Players in Ch. 11**

- **i) Existing Mgmt -**

- **a) role** – either **(i)** continues to run company as DiP **OR (ii)** replaced
- **b) authority** – decisions O/S normal business ops require crt approval (regular discretion re: normal ops)
- **c) policy for maintaining as DiP** – have most info+ preserve customer / supplier faith in company + cost of new mgmt having to learn the ropes
- **d) duty** = owed to creditors primarily (not debtors)
- **e) judicial review** ~ BJR ~ m/b **(i)** in G/F **+(ii)** on reasonable basis + **(iii)** w/i authority

- **ii) Statutory Creditors Committee (§ 1102) –**

- **a) role** – advisor + watchdog over DiP + negotiate plan of reorg
- **b) authority** – may make reasonable request for info to which DiP must respond (§ 707(b))
- **c) selection of** –
 - ⇒ § 1102(a) – US Trustee appoints seven largest **(i)** unsecured creditors and **(ii)** representatives of all unsecured claimants
 - ⇒ § 705(a) – Creditors elect from 3 to 11 members
- **d) problems** – no one wants to serve + Col where secured creditor is also largest unsecured creditor
- **e) duty** – to unsecured creditors (**In re Johns-Manville** – BCt 1983)
- **f) additional committees** –
 - ⇒ **allowed if** - **(i)** party in interest requests + **(ii)** necessary to assure adequate protection some group of creditors + **(iii)** court orders US Trustee to appoint
 - ⇒ **problem** – complicates case + makes more difficult to put together acceptable plan

- **iii) Equity Holders –**

- **a) role** – little / none
- **b) rights** –
 - ⇒ **1)** right to be heard in matters that affect them +
 - ⇒ **2)** to seek displacement of mgmt / appt of trustee +
 - ⇒ **3)** (maybe) state law right to replace BoD **IF** does not interfere w/ bankruptcy – **In re Johns' Mansville Corp** (2nd 1986)
 - ❖ **BUT** – limited value b/c BoD cannot replace mgmt w/o BCt approval prior to plan confirmation
- **c) committee** –
 - ⇒ **appointment** – SEC may request / BCt may order US trustee to appoint committee (7 largest) **IF** necessary to ensure adequate protection of S/H interests
 - ⇒ **cons** – duplication / expense
- **d) impact on plan confirmation** – deemed to reject if receive nothing

- **iv) US Trustee -**

- **role** – fills **admin functions** + operates as Creditor Committee if no CR available
 - ⇒ **admin functions** – reviews exp claims + monitors plans / disclosure stmts + monitoring CR Committees . . .
- **effect** = failure – b/c – lack of uniformity + too actively involved + under-funded + lack of direction + stuck on reviewing re-imbursement claims
- **v) Trustee** – § 1104
 - **a) role / duties** (§ 1106) – **(i)** replace mgmt + **(ii)** investigate Debtor + **(iii)** make written report on investigation + **(iv)** either **(a)** prepare plan of reorganization **(b)** recommend conversion to other chapter **OR** dismissal
 - **b) appointment** –
 - ⇒ **requestable by** – any party in interest
 - ⇒ **Court allows** – if **both**
 - ❖ **A)** notice + opp t/b heard occurs **AND**
 - ❖ **B)** either
 - **i) for cause** – including fraud, dishonesty, incompetence, mis-mgmt (**either before / during case**)
 - **ii) interest of creditors / owners** – based on 4 factors – **(i)** trustworthiness of Debtor + **(ii)** past / present performance of business and prospects of rehab + **(iii)** confidence in mgmt + **(iv)** benefits of trustee appointment balanced against costs
 - ⇒ **in practice** – Court has great flexibility + tolerates significant incompetence by existing mgmt
 - ⇒ **selection method** = either **(i)** creditors may elect **OR (ii)** US Trustee appoints (if creditors <> elect)
 - ⇒ **effect** – terminates Debtor's exclusivity period
 - **c) dismissal** (§ 1105) – possible (w/ appointment of new mgmt) / but rare
- **vi) Examiner** – § 1104
 - **a) role** – **(i)** investigate fraud / dishonesty / incompetence / misconduct / mis-mgmt / irregularity by current / former mgmt + **(ii)** report to court + **(iii)** (may include) recommendation
 - **b) appointment** – by court when
 - ⇒ **1) mandatory appointment** = if **(i) motion made AND (ii)** Debtor's fixed, unliquidated unsecured debts (excluding **(a)** debts re goods / services / taxes + **(b)** insider debts) > \$5M – **In re Revco** (6th 1990)
 - ❖ **motion made** – by any party in interest (including US Trustee)
 - ⇒ **2) discretionary appointment** = if **(i)** motion made **AND (ii)** in interest of creditors / owners / others w/ interest in estate
 - **c) cons** – expensive + duplicative of C/C
- **vii) Bankruptcy Judge** –
 -
- **vii) SEC** – § 1109
 - **a) role** –
 - **b) rights** = raise (??) + appear + to be heard (NOT to appeal)
- **viii) Professionals** -

➤ Chief Restructuring Officer (and other turn around specialists)

• **E) Retaining professionals –**

• **F) Property of estate (§ 541) –**

- **i) includes –**

- **A) pre-petition property** – all legal / equitable interests of Debtor in property as of commencement of case
- **B) community property** – all interests of Debtor + Debtor's spouse
- **C) property recovered during case** – e.g., by Trustee from 3rd parties
- **D) property rights preserved for estate** ~ avoidable interests of 3rd
- **E) post-petition “windfalls”** (§ 541(a)(5)) –
 - ⇒ **generally** – post-petition property <> go to estate
 - ⇒ **windfall exception** = if **(i)** post-petition w/h/b part of estate if was in possession of Debtor when case began + **(ii)** Debtor acquires / becomes entitled to w/i 180 days of petition + **(iii)** property received either **(a)** by bequest / devise / inheritance **or** **(b)** as result of property settlement / divorce decree **or** **(c)** as beneficiary of life insurance / death benefit plan
 - ⇒ **policy** – mitigate impecunious Debtor from filing petition prior to receiving foreseeable benefits
- **F) post petition proceeds / earnings of estate property** ~ includes proceeds, products, offspring, rents, or profits of / from estate property
- **G) post petition property acquired by estate** (§ 541(a)(7) – e.g., products manufactured by estate during bankruptcy
- **H) Debtor earnings re: pre-petition services** (implicit from § 541(a)(6)) – if received post-petition → court must allocate b/w pre/post petition (but little guidance in case law)

- **ii) excludes –**

- **A) post-petition Debtor earnings (for personal services)** – § 541(a)(6) –
- **B) any lessee interest remaining once stated term of N/R real property lease expires** – § 541(b)(2) –
 - ⇒ **Limits** – applies only to leases expiring as scheduled (~ not accelerated lease termination due to default)
 - ⇒ **Note** – § 362 automatic stay still governs lessor's right to evict Debtor
- **C) power of Debtor exercisable solely for benefit of another person** (~ power of appointment under trust) – § 541(b)(1)
 - ⇒ **policy** – preserve ability of grantor of power to determine who exercises such power + no benefit t/b gained by CR
- **D) equitable interest in property re: where Debtor holds only legal title** – § 541(d) – trust gets legal title (not equitable title)
- **E) non-assignable beneficial interests in trust** - § 541(c)(2)
 - ⇒ **applies re** –
 - ❖ pension funds – Debtor EE's interests therein
 - ❖ spendthrift trusts –
- **E) other narrow exemptions related to individual Debtors** – § 541(b)(3-5)

- **iii) effect of transfer restrictions** (~ loan covenants) -
 - **generally** – no effect (~ do not restrict transfer of property to estate) – § 541(c)(1)
 - **exception** – beneficial interests in trusts subject to enforceable non-bankruptcy transfer restrictions

• **G) Claims, interests, & priorities -**

- **i) claim** -

- **a) includes** – (i) obligation owed / potentially owed + (ii) right against debtor to equitable remedy arising from breach of K + (iii) **contingent / unliquidated** rights to payment
 - ❖ **contingent / unliquidated** – court values by either
 - **a) lifting automatic stay** / allowing full trial on merits (~ w/ considerable delay) **or**
 - **b) estimating value** (~ when liquidating claim will unduly delay admin of case)
 - **NOT allowed for personal injury / wrongful death claims**

Rolfitz / Borne v. Bittner

➤ **b) types** -

⇒ **1) secured claim** ~ where claimant (i) is owed debt + (ii) has collateral securing debt (~ claim coupled w/ an interest)

- ❖ **A) after acquired property** (§ 552(b)) = subject to pre-petition lien **IFF** either
 - **i) court orders (i) after notice / opp for hearing + (ii) equities allow** **OR**
 - **ii) all of the following**
 - **a) after acquired property is proceeds, product, offspring, rents, or profits of property subject to a security agreement (~ includes all consensual liens) prior to commencement** **AND**
 - **b) security agreement says lien extends to after acquired property** **AND**
 - **c) provision re: extension to after acquired prop = enforceable per non-bankruptcy law**
- ❖ **B) Bifurcation** (§ 506) – undersecured debt = bifurcated b/w (i) secured (value of collateral) and (ii) unsecured (residual claim)
- ❖ **C) subject to automatic stay** –
- ❖ **D) seizing property** – not allowed w/o a lien (involuntary = judgment lien; voluntary = mrtg)

⇒ **2) unsecured claim** – simply a debt (~ see (iii)(b) below)

➤ **c) required for recognition** –

⇒ **1) claim must be allowed**

- ❖ **allowed** ~ if proof of claim filed (or claim scheduled for Ch. 11) **unless** objection filed (--> court determines after notice and opportunity to be heard)

⇒ **2) limits to amount** (§ 502) - **IFF** objection is made (O/W claim valued per proof of claim)

- ❖ **a) secured claim** – limited to lesser of (i) value of property securing the debt **or** (ii) debt owed
- ❖ **b) R/E lessor claim** – limited to (i) past due rent + (ii) greater of (a) one yrs rent **or** (b) 15% remaining rent on lesser of (y) remaining lease term **or** (z) 3 yrs
- ❖ **c) post petition interest** –

- i) **generally** – NOT allowed (e.g., never allowed for unsecured debt)
- ii) **Ch. 11** - depends on period
 - **A) Plan period** --> payments must include compensation for lost use of money (~ interest)
 - **B) Pendency period** –
 - > **1) Generally** interest generally not allowed during **pendency period**
 - ◆ **pendency period** – b/w Case commences & Plan confirm
 - > **2) secured claim exception** - § 506(b)
 - ◆ **a) may be claimed by** –
 - i) **consensual lien holders** – get interest + fees
 - ii) **non-consensual lien holders** – get only interest (not fees) - **US v. Ron Pear Enterprises** (US 1986 – the “Comma Case”)
 - ◆ **b) extent of allowed interest** – depends on ~ equity cushion
 - i) **oversecured claim** – interest allowed up to amount of surplus collateral
 - ii) **undersecured claim** – no interest allowed – **USAT v. Timbers** (US 1988)
 - ◆ **c) rate of interest** – either K interest rate (consensual liens) or court determined rate (non-consensual liens)

Key Bank v. McMillan Case –

key → rate is discretionary for court

Key only covers the admin period

If court does not give K rate → becomes costly battle of experts (~ 99% time this is settled)

What happens to int → either (i) paid or (ii) capitalized (if not enough money in estate)

Risk factors – new capital structure of business + coercing CR to give new loan in which no excess collateral exists + possibility business will fail again

- ◆ **d) criticism** – forces undersecured creditors to finance reorg
- ◆ **e) policy** – all CR suffer in reorg

- ❖ **d) contingent / unliquidated claims** – **see 3(G)(i)(a) above**
- ❖ **e) property taxes** – allowed only to extent of value of estate’s interest in property (~ non-recourse claims)
- ❖ **f) services of insider / atty** – limited to reasonable value of services
- ❖ **g) EE termination dmgs** – limited to **(i)** comp unpaid at termination + **(ii)** 1 yrs salary

– ii) **interest** - _____

- **includes** – **(i)** right to specific property of estate (~ co-ownership / lien) + **(ii)** right to residue of estate after all claims satisfied (~equity)
- **required for recognition** - interest must be **allowed** (**allowed** ~ if proof of interest filed (or scheduled for Ch. 11) **unless** objection filed (Code has no rules re: adjudication of interest b/c usually worthless)

- **iii) priorities** -

- **a) secured debt** – see Ch. 2
 - ⇒ 1) **perfected security interest** –
 - ❖ consider perfection rules for preferences???? – **see 3(K) below**
 - ⇒ 2) **judicial lien** -
- **b) prioritized unsecured debt** (§ 503 + § 507) – prioritized 1-10 as follows
 - ⇒ **1-a) super-priority administrative expenses** (§ 507(b)) – in order of priority
 - ❖ **A) § 364(c) DiP financing** –
 - ❖ **B) insufficient A/P to secured CR** -
 - ⇒ **1-b) administrative expenses** (§ 503(b)) = expenses of bankruptcy proceeding including the following
 - ❖ **A) costs to preserve estate** – post petition services, taxes, § 364(a/b) DiP financing etc.
 - ❖ **B) compensation** – Trustee, examiner, professional, Debtor's atty
 - ❖ **C) reimbursement / compensation of professionals** – including expenses of CR, Trustee, taken for benefit of estate
 - ⇒ **2) gap period claims** (§ 507(a)(2) + § 502(f)) – claims arising in ordinary course of T/B after commencement of case but before the earlier of **(i)** order for relief **or (ii)** appointment of Trustee
 - ⇒ **3) wage claims** – **(i)** earned w/i 90 days before filing petition + **(ii)** limited to \$4,000 / claimant
 - ⇒ **4) contribution to EE bene plans** – **(i)** arising w/i 180 days of earlier of **(a)** filing petition or **(b)** ceasing business + **(ii)** limited to [\$4,000 X number of EE's – amounts paid to EE's as wages claims or other EE bene plans) – indexec to CPI]
 - ⇒ **5) farmers / fishermen** -
 - ⇒ **6) individual buyers w/ down payment / lay away deposit** -
 - ⇒ **7) alimony / maintenance support** -
 - ⇒ **8) taxes / customs duties / penalties** – no dollar limit BUT time limits apply
 - ⇒ **9) re: obligations of undercapitalized insured depository institutions** – no cap
- **c) general unsecured debt** – includes - consumer debt + business debt + tort obligations
- **d) subordinated debt** – arises by either -
 - ⇒ **1) K subordination** – enforceable to extent enforceable under non-bankruptcy law
 - ⇒ **2) equitable subordination** (§ 510(b)) – where inappropriate to treat on par w/ similar debts – **deep rock doctrine**
 - ❖ arises for = either of 2 reasons –
 - **i)** where claim is substantively different than what it appears to be **OR**
 - **ii)** punitive for bad behavior of claim holder

◦ **test** – depends on circuit

> 5th / 8th (majority) - requires **all** of **(i)** holder engaged in inequitable conduct + **(ii)** misconduct injured CR / unfairly benefited holder + **(iii)** subordination is consistent w/ Public Policy & Bankruptcy provisions - **In re Mobile Steel** (5th 1977); **US v. Arlon Ind** (8th 1984)

> 7th – requires **(i)** review fairness + **(ii)** subordinated CR must O/W receive full payment **US v. Nolan** (7th) penalty tax claim for failing to file + motion to subordinate tax claim to mitigate effect on general unsecured Claim b/c gov't not harmed under Plan b/c will receive 100%

> 7th limited – Bank Crt does not have unrestrained authority to subordinate claims + only Congress should change priorities - **US v. Nolan** (US) BUT S/C does not wholly reject 7th's test

❖ arises in respect of = generally 3 types of cases –

- i) fiduciary misuses position to disadvantage of CR (~ exec raising salaries) **OR**
- ii) 3rd party controls Debtor to disadvantage of others **OR**
- iii) 3rd party defrauds other CR

➤ **e) equity interests** – prioritized as follows

⇒ **1) priority interests** – arise by K (~ P/S)

⇒ **2) general residual interests** – may be more than one class (~ both rank equally)

⇒ **3) subordinated interests** – arises by either -

❖ **A) K** **OR**

❖ **B) equitable subordination**

- **iv) absolute priority rule** – _____

➤ **generally** - each category of claim / interest entitled to full satisfaction before any jr. category receives anything

➤ **Ch. 11 specific rules** ~ flexible APR (**see 7(C)(iii)(8)(b)(iv) below**)

⇒ **relative priority** may apply **IFF** enough CR accept

❖ **relative priority** – **(i)** each priority entitled to liquidation value before jr priorities + **(ii)** w/ going-concern excess allocable per Plan

- **v) Ch. 11 specific rules** - _____

➤ **a) classification of claims** – § 1122

⇒ **generally** - allowed **IF** all of **(i)** Plan provides equal treatment w/i classes + **(ii)** substantial similarity of claims (~ broadly same stake in proceedings (not identical)) + **(iii)** classification not = gerrymandering or B/F (~ m/b something other than to win Plan approval) + **(iv)** Debtor able to obtain Plan confirmation

⇒ **exception** (§ 1122(b)) – Plan may designate separate class consisting of every **(i)** unsecured claim **(ii)** less than / reduced to amount **(iii)** court approves as reasonable / necessary for administrative convenience

⇒ **cases** -

- ❖ single asset R/E - Phoenix Mutual Life v. Greystone (5th 1992) – court rejects Debtor plan to segregate CR § 1111(b) unsecured claim b/c no basis shown for treating as distinct from trade creditor claims
 - substantially similar claims ~ sharing common priority / rights against Debtor's estate
 - generally ~ s/b in same class
 - exception (§ 1122(b)) – small unsecured claims may be separately classified IF (i) court approves (ii) for admin convenience
 - gerrymandering claims to get needed cramdown approval = B/F = not allowed **unless** Debtor shows other business purpose
 - Miller – this is case of strict construction

➤ **b) proof of claim / interest –**

- ⇒ deemed filed – IF Debtor schedules **UNLESS** claim / interest = disputed / contingent / unliquidated
- ⇒ filing proof of claim = establishes claim / interest unless disputed

➤ **c) debt related issues – § 1111(b)**

⇒ **1) non-recourse debt –**

- ❖ generally – Ch. 11 creditors treated as if have recourse claim against debtor (~under-secured non-recourse creditor gets unsecured claim for collateral deficiency)
- ❖ exception – if either -
 - **i) property sold** (§ 363) (or t/b sold through plan) – creditor gets entitlement thru sale (b/c this is what it bargained for) **OR**
 - **ii) creditor elects** (§ 1111(b)(2)) – **see (c)(2) below**

⇒ **2) under-secured claims –**

- ❖ 1111(b)(2) election – Ch. 11 creditor may elect to negate § 1111(b) benefit
- ❖ exceptions – election not allowed if either -
 - **i) collateral property value** = inconsequential **OR**
 - **ii) property sold** (§ 363) (or t/b sold through plan) – creditor gets entitlement thru sale
- ❖ effect – claim = secured claim to full extent that is an allowed claim (rather than secured + unsecured claims)
- ❖ purpose = protect against lien stripping
- ❖ limited benefit – b/c **best interests of CR test** <> apply (~ plan confirmation requires only that Debtor pay nominal value of **collateral** (as of the plan effective date)) § 1129(A)(7)
 - **best interests of CR test** - all creditors not approving plan receive PV payments equal to the Ch. 7 liquidation value (~ cramdown does not help) – see 7(B)(ii) below
- ❖ beneficial where – either (i) Plan covers limited period (~ so PV ~ nominal value) **or** (ii) collateral may appreciate in value **or** (iii) CR believes DR may file bankruptcy again

- **vi) other issues -**

➤ **a) co-ownership –**

- ⇒ **1) consider -**

- ❖ co-owner <> have claim against estate nor interest in debtor
- ❖ co-ownership right <> interest in property of estate b/c co-owner's interest <> become property of estate (exception = community property)

⇒ **2) sale of property** (§ 363(h) –

- ❖ generally – court must sell / distribute only Debtor's portion unless would impair value thereof
- ❖ exception – court must sell property if **all** of **(i)** in-kind partition = impracticable + **(ii)** sale of estates interest would realize significantly less than w/ sale of whole property + **(iii)** benefit to estate outweighs detriment to co-owners + **(iv)** property <> used in production / transmission / distribution of electricity / gas / heat / light / power

⇒ **3) leases** –

- ❖ lessor's interests = **(i)** in rent + **(ii)** in Debtors leasehold interest (prop of Debtor's estate) **???** + **(iii)** right to get property back (never part of Debtor's estate)

- **b) anomalous rights** – if can't class rights → class functionally (equity substance treated as equity)
- **c) set off** -

• **G-2) Automatic Stay** –

- **i) Effect** – _____

- **generally** - actions taken violating Auto Stay = void ab initio, even if actor had no notice of stay (~ prevents exercise of CR rights / does not destroy rights)
- **sanctions** – for violating stay
 - ⇒ **civil contempt** – applies to actions knowingly taken in violation of Auto Stay (**unless** inadvertent)
 - ⇒ **stat sanctions** § 362(h) – for willful violations → court = empowered to assess – actual damages, costs, atty fees, punitive damages
- **sovereign immunity** – waived if gov't files proof of claim – § 106

- **ii) applies re** – _____

- **a) discretionary (judicial) stays**– § 105(a)
 - ⇒ **re: 3rd parties** - granted only **IF** non-debtor O/W faces irreparable injury - **In re AH Robins** (4th 1986) – B/C stayed product liability action (~ Dalkon shield) against Robins insurer until Robins reorganized b/c Robins inexorably w/b drawn in
- **b) statutory stays** - § 362(a) –
 - ⇒ **1) judicial / administrative actions** (against Debtor) - which were / c/h/b initiated pre-petition
 - ⇒ **2) enforcement of pre-petition judgments** (against Debtor + property of estate)
 - ❖ excludes - property of Debtor (BUT see exemptions which protect property exempted from bankruptcy)
 - ⇒ **3) any act to (exercise control of / obtain possession of property) of / from estate** – even property simply in estate custody
 - ❖ excludes - property of Debtor (BUT see exemptions which protect property exempted from bankruptcy)
 - ⇒ **4) any act to collect / assess / recover any pre-petition claim against Debtor** -

- ❖ excludes - property of Debtor (BUT see exemptions which protect property exempted from bankruptcy)
- ⇒ **5) liens** – effect depends on whom enforceable against
 - ❖ property of estate – all liens stayed
 - ❖ property of Debtor – only liens securing pre-petition obligations stayed
- ⇒ **6) set off** – prohibited IF the claim owed to Debtor (by CR) arose pre-petition – § 362(a)(7)
 - ❖ but – admin hold by bank while seeking lifting of stay <> setoff b/c (i) temporary + (ii) not take possession / control over Debtor property - **Strumpf**
- ⇒ **7) any other effort to collect** – including
 - ❖ **1) self help repossession** – **In re Holman** (Bank SD Ohio 1988)
 - ❖ **2) coercing patrons not to patronize Debtor** – **In re Sezchuan** (Bank ED Pa 1989)
- **iii) not applied to** – but **subject to** B/S § 105 power to enjoin recovery under stat exception _____
 - **a) after end of bankruptcy** ~ case closed / dismissed **or** discharge granted / denied
 - **b) property not administered by estate** (~ abandonment) – § 362(c)(1)
 - **c) last minute pre-petition liens** – liens re: credit extended during preference period → may be perfected IF both (i) perfected w/i 10 days of lien attachment (t/b effective against Trustee / DiP + (ii) lien attached at approximately same time as credit extended – § 362(b)(3)
 - **d) expired commercial R/E leases** – lessor may retake possession IFF lease’s stated term expired (~ irrespective when lease expired relative to petition)
 - **e) negotiable instruments** – holder-CR may present / give notice of dishonor / protest dishonor of negotiable instrument
 - ⇒ why – b/c UCC Art 3 deadlines might O/W release co-obligor from obligation under the negotiable instrument
 - **f) governmental / regulatory actions (to protect public interests)** – including (i) criminal proceedings + (ii) enforcement of non-money judgments + (iii) tax reviews
 - ⇒ key – distinguish b/w (i) proceeding (~ allowed) **and** (ii) seizure pursuant to money judgment (~ not allowed)
 - ⇒ excluded from exception = vindication of pecuniary interests
- Brennan notes** -
 - **g) communications merely re: fact of debt** – **Morgan Guaranty v. American Savings & Loan – ftnt 9** (9th 1986)
 - **h) obligations of 3rd parties** (generally) - even if 3rd party = affiliate
 - **i) certain personal items** – including alimony, maintenance, support, paternity
- **iv) modification / relief from stay** – § 362(d) _____
 - **requires** – all of (i) court so rules + (ii) at request of party + (iii) after notice / hearing + (iv) **for cause** shown + (v) re property in which Debtor does not have an equity + (vi) such property not necessary to reorg

⇒ **for cause** ~ includes –

- ❖ **A) lack of adequate protection** – **see 3(l) below**
- ❖ **B) better forum re: matters tangential to Bankruptcy** – stay may be partially lifted (excluding collection / enforcement actions)
- ❖ **C) no equity in prop / not needed for effective reorg** – **both** requirements m/b met
 - **no equity** ~
 - **not needed** ~ **(i)** implies that reorg possible + **(ii)** m/b more than convenient to estate
- ❖ **D) single asset case** – stay may be lifted 90 days after petition if Debtor **(i)** <> file Plan w/ reasonable possibility of confirmation + **(ii)** <> making monthly payments – § 362(d)(3)
- ❖ **E) Leasehold interest** – courts disagree whether LH int entitled to A/P: only under § 365 (~ assumption of leases) or also § 362 (~ A/P)
 - some courts – stay lifted prior to assumption / rejection if no A/P
 - other courts – no lifting of stay
- ❖
- ❖ **E) other reasons** - ??? – generally not raised in court

➤ **key considerations** – **(i)** standing for relief almost always requires interest in property + **(ii)** court may grant partial / conditional relief + **(iii)** court may revisit relief issue as circumstances change (~ not res judicata)

➤ **procedure for relief** -

⇒ **normal relief** - court response to request either **(i)** decision w/i 30 days or stay terminates automatically **or (ii) (a)** notice / opportunity for hearing + **(b)** continuance of stay pending final decision w/i additional 30 days (unless courts finds **compelling circumstances**) – (§ 362(e))

❖ **compelling circumstances** -

⇒ **emergency ex parte relief** – only if action necessary to prevent **(i)** imminent + **(ii)** irreparable damage to claimants property – § 362(f)

⇒ **Bo Persuasion** –

- ❖ Requestor of relief = re: Debtor's equity in property
- ❖ DiP / Trustee = all other issues

- **v) Forms of relief** - _____

- **ab initio** – validates prior actions that violated auto stay
- **self executing** – stay lifts automatically if some form of future lapse by Debtor
- **particularized b/w CR** -

- **vi) Policy** – _____

- goal – procedural protection of to keep estate together

- set off – does not include hold on bank account balance for amount of defaulted loan **IF** hold not permanent – **Citizens Bank v. Strumpf** (US 1995)

- application to 3rd parties = appropriate if indemnification to debtor is at issue b/c insurance K = property of estate – **Robins v. Piccinin** (4th 1986)

- adequate protection –
- **Marvel** (DE cases discussed in class) – is Indenture Trustee / Icahn voting collateral stock per Indenture Agreement exercising creditor rights even after gains control of voting stock
 - DE C/A judge – biased DE law – concerned that w/b restraining S/H rights by not allowing Icahn to vote
 - Court finds – Icahn is exercising S/H rights
- **US v. Whiting Pool** – Miller says a very important case
- **Potter Instrument** – case highlighting flip side of Marvel, focusing on risk to reorganization process of allowing debtor to avoid auto stay and vote equity interests obtained under credit agreement

• **H) Executory K – Assume / Reject -**

- **i) Rule** (§ 365(a)) – DiP may assume / reject any executory K or unexpired lease
- **ii) is K / lease executory** – depends on which defn
 - **a) Countryman defn** (majority) - if obligation of both Debtor and non-debtor parties remain so far unperformed that failure of either to complete would constitute material breach excusing performance
 - **b) Westbrook functional defn** (minority) – determined by benefits that assumption / rejection would produce for the estate
- **iii) is rejection beneficial?** – DiP decision to reject = reviewed under BJR standard - **Lubrizol**
- **iv) DIP options** – _____
 - **a) reject** = breach (not discharge / extinction of underlying obligation)
 - ⇒ **extent** = all or nothing – **Rovine** (B/C Tenn 1980) – *non-bankrupt unsuccessfully argues that non-compete clause was not rejected w/ BK franchise K*
 - ⇒ **policy for allowing** – **(i)** any party may reject any K at any time (subject to dmgs) + **(ii)** crippling effect on Debtor + **(iii)** creditors w/ unexecuted K w/h better rights than creditor claims re: completed K
 - **b) assume** –
 - ⇒ **requires** - (§ 365(b))
 - ❖ **generally** - DiP/trustee must **(i)** cure default (or provide adequate assurance that will cure) + **(ii)** compensate for actual pecuniary loss caused by default (or provide adequ. assurance of comp.) + **(iii)** provide adequate assurance of future performance
 - ❖ **exceptions** – DiP may ignore defaults re: **(i)** ipso facto clauses re: financial condition / bankruptcy + **(ii)** penalty rate / provision arising from failure to perform non-monetary obligation
 - ⇒ **effect** – creates § 503(b)(1) admin expense w/ admin priority
 - ❖ **re: non-residential R/E** → admin exp for all future rent under lease (no cap) – **Montgomery Ward** (3rd 2001)
 - ⇒ **extent** = all or nothing
 - **c) assume & assign** -
 - ⇒ **requires** (§ 365(f)(2)) – **(i)** Debtor properly assumes (see above) + **(ii)** provide adequate assurance of future performance by assignee
 - ⇒ **limits** –
 - ❖ **A) non-delegable duties / non-assignable benefits** (more rare) –
 - **includes** -
 - **a) personal services**
 - **b) extension of credit / issuance of securities** - § 365(e)(2)(B)
 - > irrespective of consent of other party
 - > application = narrow (only if focus of K = credit / securities)

→ **solution** - enter new K (BUT likely requires court approval)

❖ **B) non-bankruptcy law prohibitions** – no assumption / assignment if federal / state non-bankruptcy law prohibits w/o consent (irrespective of K) (§ 365(c)(1))

⇒ **extent** = all or nothing

- **v) courts role** – _____
 - **BJR applies** - B Crt reviews business judgment of DiP in assuming / rejecting K (just m/b separate proceeding form any related adversary proceeding (~which B Crt can still hear)) - **Orion v. Showtime** (2nd 1993) -
- **vi) remedy to other party** (§ 365(g)) – only dmgs (no specific performance) _____
- **vi) deadline for decision** – _____
 - **generally** -
 - ⇒ **Ch. 7** – w/i 60 days of order for relief **unless** court extends
 - ⇒ **Ch. 11** - time of plan confirmation **unless** court sets other date
 - **non-residential R/E** – accept w/i 60 days of order for relief (**unless** court extends) or lease deemed rejected
- **vii) special rules** - _____
 - **a) Damages caps on LT K**
 - ⇒ **i) EE claims** (§ 502(b)(7) – limited to K rate of compensation for 1 yr following earlier of **(i)** petition **or** **(ii)** EE term
 - ⇒ **ii) unexpired R/E leases** (§ 502(b)(6) – LL claim = limited to rent under lease for lesser of **(i)** 3 yrs **or** **(ii)** greater of **(a)** 1 yr **or** **(b)** 15% of the remaining lease term
 - **b) non-residential R/E leases** (§ 365(d)) –
 - ⇒ **i) deadline for decision** - accept w/i 60 days of order for relief (**unless** court extends) or lease deemed rejected
 - ⇒ **ii) interim lease obligations**– Debtor must timely perform all lease obligations until assumes / rejects lease (court may allow delinquency so long as occur w/i 60 days after order for relief)
 - ⇒ **iii) if rejecting debtor = lessor** → existing tenant may either **(i)** vacate premises / treat rejection as breach **OR** **(ii)** remain on premises for remaining lease term and any renewal (whether or not in possession)
 - ⇒ **iv) if assigning debtor = lessee** → lessor may demand new security deposit from new tenant **IFF** on substantially same terms w/h offered to similar tenants (§ 365(l))
 - **c) Employment K** (§ 1113) –
 - ⇒ **prior to rejecting** – DiP must **(i)** propose to union modifications to empt K needed to permit reorg + **(ii)** confer in G/F w/ union to achieve mutually satisfactory modifications
 - ⇒ **court approval of rejection** = only if both **(i)** union refuses to accept Debtor's proposal w/o good cause + **(ii)** balance of equities clearly favor rejection
 - **d) intellectual property licence K** (§ 365(n)) -
 - ⇒ **licencee has choice** (when Debtor rejects) - either
 - ❖ **A)** treat agreement as terminated **IFF** rejection constitutes a material breach **or**

- ❖ **B)** elect to retain rights to **intellectual property** under licence (~ must continue to pay royalties at the K rate, cannot require specific performance of Debtor obligations, licence lasts for stated term plus extension)

- ❖ **intellectual property** (§ 101(35A)) - includes trade secrets, patent inventions, C/R materials, **but not** T/M

- **e) personal property leases** (§ 365(d)(10)) -

- ⇒ **i) interim rental payments** – Debtor must make rental payments IFF **(i)** relate to period beyond 60 days after order for relief + **(ii)** re: commercial lease + **(iii)** court does not O/W relieve DiP of obligation

- **f) shopping center leases** – generally more protection than other R/E leases

- **I) Adequate Protection – § 361**

- **i) Re: automatic stay modification – § 362**

- **Available to / allowed amount –**

- ⇒ **1) Leasehold interest** – courts disagree whether LH int entitled to A/P: only under § 365 (~ assumption of leases) or also § 362 (~ A/P)

- ❖ some courts – stay lifted prior to assumption / rejection if no A/P
 - ❖ other courts – no lifting of stay

- ⇒ **2) over-secured CR** = nominal value of secured claim (principal + allowed pendency interest)

- ⇒ **3) under-secured CR** – nominal value (no A/P for pendency interest) – **US savings Assoc v. Timbers** – US 1988 – A/P does not include compensation for use of property during pendency period)

- **Forms of A/P** – must ensure claimant the realization of value of an indubitable equivalent to interest in prop

- ⇒ **1) Include -**

- ❖ **A) payments** ~ amount of periodic decrease in value of claimant's interest in property

- ❖ **B) additional / replacement lien** – (e.g., revolving lien in inventory) – **American Kitchen**

- ❖ **C) equity cushion** – (~ *is this really a judicially recognized non-statutory exception?*)

- ❖ **Note** - Cr may seek more later + CR gets pendency interest

- ❖ **D) other forms of indubitable equivalence** ~ insurance / 3rd party guarantee

- ⇒ **2) Not sufficient –**

- ❖ **A) administrative priority claim** - § 361(3)

- ❖ **B) doubtfully secured / speculative promise** – **In re Murel** (2nd 1935)

- **if insufficient A/P** → CR gets superpriority administrative expense claim (§ 507(b))

- **Policy for allowing -**

- ⇒ **Constitutional grounds** – 5th Amendment protection of property interest

- ⇒ **Policy grounds** – secured CR s/n/b deprived of benefit of their bargain (especially where already barred from absolute right to his bargain under auto stay b/c exercise of right would contravene purpose of Bankruptcy) + but everybody suffers (~ re: no pendency interest for under-secured CR)

- **ii) DiP Financing – § 364(d) lien priming** _____
 - **A) under secured CR –**
 - ⇒ **i) additional collateral required** - Debtor must provide some form of additional collateral to satisfy the § 364(d) adequate protection requirement in respect of an undersecured Creditor - **Resolution Trust v. Swedeland** (3rd 1994) *golf course Debtor tries to convince court that future improve benefit provides sufficient A/P to secured CR*
 - ❖ Policy – if secured CR not protected → bears uncompensated risk of operations solely for benefit of other CR
 - ⇒ **ii) no A/P to extent under secured** (e.g., no interest accrues) – **US Savings v. Timbers** (US 1988)
 - **B) over secured CR –**
 - ⇒ **no additional consideration** is needed where the CR is so over secured that no risk exists of becoming undersecured – **In re Sky Village** (Bank ND GA 1988)
 - ⇒ **A/P of excess** – CR is entitled to interest
 - **C) Forms of A/P –**
 - ⇒ **includes** - any of **(i)** periodic cash payments + **(ii)** additional / replacement liens + **(iii)** other relief resulting in CR realization of **indubitable equivalent** of their interest – **In re Reading Tube** (BED PA 1987)
 - **indubitable equivalent** –
 - **equity cushion** – some courts - view as sufficient; other courts – view as bargained for by CR
 - ⇒ **excludes** -
 - ❖ increased going concern value – not sufficient A/P (~ this is in nature of investor right / not CR)
 - ❖ pre-existing personal guarantee - **Swedeland**

- **In re Bermeo** – creates concept of adequate protection to deal w/ economic depreciation
- **In re American Kitchens** – recognized Congressional policy for reorg by recognizing value / allowing D to use cash collateral
- **Alluycan Interstate** – adequate protection = reasonable prospect of reorg (not simply equity cushion)

- **J) prorate ??? -**

- **K) Avoidance Actions -**

- **i) Effect of avoidance** - _____
 - **generally** ~ Trustee **(i)** avoids transfer / lien (<> void transaction) + **(ii)** assumes the rights avoided
 - **if Jr / Sr liens on prop** (§ 551) – if avoid Sr. lien → trustee takes over Sr. lien (Jr. lien remains Jr.)
 - ⇒ **policy** – Congress believes benefit of avoidance should go to unsecured creditors (whom transferee joins)
- **ii) Avoidance powers** – _____
 - **A) strong arm clause** (§ 544(a)) – allows DiP / trustee to avoid “incomplete” transfers (~by giving rights of one of the following -
 - ⇒ **1) hypothetical judicial lien** on all property which CR on simple K c/h obtained per judicial lien (even if no such CR exists)

- ❖ Significance – gives DiP / trustee priority over unperfected Art 9 security interests (subordinate to only perfected security interests)
 - ❖ Criticism – perfection rules were to protect secured CR / lienholders (not help unsecured CR)
 - ❖ Justification – prophylactic measure policing against fraud
- ⇒ **2) BFP of realty** (other than fixtures) – permitting the avoidance of incomplete transfers of realty (irrespective of whether any BFP is actually in case)
- ❖ Significance – depends on State law
 - If any hypothetical BFP could avoid transfer under state law → DiP / trustee can avoid
 - If state law is such that no BFP could exist who could avoid → DiP trustee cannot avoid (e.g., if a possession protects from all BFPs, irrespective of knowledge thereof)
- ⇒ **3) hypothetical CR who (a)** extended credit at time Case commenced **and (b)** obtains execution against Debtor that is returned unsatisfied – insignificant
- **B) non-bankruptcy avoidance powers of unsecured CR** (§ 544(b)) – allows DiP trustee to enforce non-bankruptcy avoidance rights O/W available to existing CR
- ⇒ Limits / restrictions –
- ❖ **a)** look to the applicable non-bankruptcy law (~ note that state law may be more lenient than Bankruptcy Code, e.g., re : fraudulent transfers)
 - ❖ **b)** does not allow DiP / Trustee to assert other rights of CR
 - ❖ **c)** avoidance right may be extinguished / diminished by CR's pre-petition actions
- **C) avoidance of statutory liens** (§ 545) – allows DiP / Trustee to avoid the fixing of **(i) stat lien** on **(ii)** prop of Debtor
- ❖ statutory liens –
 - includes –
 - **A)** liens pegged to financial distress / failure of Debtor +
 - **B)** liens not perfected / enforceable against hypothetical BFP (irrespective of whether BFP present in case) +
 - **C)** liens for rent / rent distress (even if not created by stat)
 - excludes – consensual / judicial liens + security interests + all judicial liens (even if created by stat)
- **D) Post petition transfers of property** (§ 549) –
- ⇒ **generally** - avoidable (unless authorized by Code / Court) **IF** avoidance action commenced before earlier of **(i)** 2 yrs after transfer **or (ii)** close / dismissal of case
- ⇒ **exceptions** – re
- ❖ **a) R/E transfers** (§ 549(c)) – transferee keeps property if all of **(i)** is G/F purchaser + **(ii)** transferee <> Case commenced + **(iii)** transferee paid **present** FMV for property + **(iv)** deed was recorded prior to notice of petition filed in R/E records (~ perfected???)
 - **present value** – excludes satisfaction of pre-existing debt
 - ❖ **b) for value exception** (§ 549(b))- transfer = valid to extent that transferee gave value both **(i)** after petition **and (ii)** in exchange for the transfer (even if transferee knows of filing)
 - ❖ **c) SOL** – action m/b commenced by earlier of **(i)** 2 yrs after transfer date **or (ii)** time case is closed / dismissed

➤ **E-1) Fraudulent transfers (Federal)** (§ 548) - either

⇒ **Avoidance requires** – both (i) transfer made / obligation incurred w/i 1 yr of petition + (ii) either

❖ **i) actual fraud** – w/ intent to hinder / delay / defraud any entity was / became indebted (~ difficult to prove)

– **badges of fraud** – transfer in favor of insider + Debtor retained possession / control after transfer + transfer / obligation was concealed + Debtor threatened w/ suit prior to transfer + transfer of substantially all assets + Debtor attempted to conceal themselves (~ absconded) + Debtor removed / concealed assets + value received <> reasonably equivalent + Debtor was / became insolvent + transfer = before / shortly after incurring substantial debt + Debtor transferred essential assets of business

❖ **ii) civil constructive fraud** – Debtor both (i) received less than **reasonably equivalent value** + (ii) either (a) was **insolvent** (B/S insolvency) at time of transfer **or** (ii) left insolvent as result of transfer

– 1) did Debtor get **reasonably equivalent consideration** for transfer
if YES = OK ; if NO goto 2

> **reasonably equivalent consideration** <> FMV – **In re BFP** (US 1994)

◆ **majority** – totality of circumstances test – (i) presumes that value was equivalent + (ii) allows Debtor to rebut presumption

◆ **5th** – 57.7% of FMV is not sufficient where only one bidder present (70% maybe required) – **Durett v. Washington Nat'l Life** (5th 1980) – court sets aside foreclosure value as a fraudulent transfer b/c of inadequate value

◆ **9th** – respects the result of a non-collusive, regularly conducted sale, open to all bidders – **In re BFP** (9th 1992)

– 2) did transfer occur at time Debtor insolvent - **if YES = BAD ; if NO = goto 3**

– 3) was effect of transaction w/ unreasonably small capital w/ which to operate business (ignoring insolvency) **if YES = BAD ; if NO = goto 4**

– 4) was transfer made when Debtor intends not to pay future debts
if YES = BAD ; if NO = OK

➤ **E-2) Fraudulent transfers (State)** – probably has longer than 1 yr limit

➤ **F) Preferences** (§ 547) –

⇒ **Applies if** – (i) transfer (*voluntary / involuntary*) (ii) of property (iii) to/for benefit of CR (iv) on antecedent debt (not contemporaneous exchange) (v) made while Debtor **insolvent** (vi) and made during **preference period** (vii) enabling CR to receive more than would O/W get in Ch. 7 liquidation of Debtor

– **insolvent** ~ B/S insolvency (w/ stat presumption of insolvency in 90 days before bankruptcy)

– **preference period** – 90 days (~ insiders = 1 yr)

❖ **Date of transfer** (§ 547(e)(2)) – depends on when perfected

– **i) If perfected before petition** -

- **A)** if perfected upon transfer or w/i 10 days → transfer occurs on date effective
- **B)** if perfected > 10 days after effected → transfer occurs on date perfected
- **ii) if perfected post petition -**
 - **C)** if perfected > 10 days after effected and after commencement of case → transfer deemed immediately prior to petition
 - **D)** if perfected w/i 10 days after effected

⇒ **Exceptions** – § 547(c)

- ❖ **a)** substantially contemporaneous exchange for new value (~ checks)
- ❖ **b)** ordinary course of business transactions (§ 547(c)(2))
- ❖ **c)** grace period for perfection (see date of transfer above)
- ❖ **d)** advance of new value subsequent to purchase – allows set off of post preferences advances of credit if certain conditions met (§ 547(c)(4))
- ❖ **e)** net result rule – floating lien in generic pool of collateral (~ only inventory, receivables, their proceeds)
- ❖ **f)** statutory liens ~ mechanics liens, etc.

⇒ **Indirect Preferences** -

- ❖ Present where – insider receives indirect benefit during preference period due to O/W allowed transfer to 3rd party
- ❖ Treatment – Trustee may not recover preference from a transferee that is not an insider (§ 550(c))

⇒ **policy** – for allowing avoidance of preferences ~

- ❖ **i) preserve estate** – contra's CR incentive to cherry pick assets
 - BUT ~ CR don't think about this (or think will not get caught)
- ❖ **ii) preserves** - Congressionally determined priority structure as to equal distributions -

⇒ **differ from fraudulent transfers** b/c **(i)** preferences not avoidable under state law + **(ii)** usually = bona fide obligations

➤ **G) Set-offs** – 2 types

- ⇒ **A) Pre-petition setoffs** – may be avoided to extent (i) occurred w/i 90 days prior to bankruptcy + (ii) setoff reduced **insufficiency** (~ excess of CR obligation to Debtor over Debtor obligation to CR)
- ⇒ **B) DR return of goods** (§ 547(g-2)) – Dr may return goods / CR may offset purchase price **IF (i)** court determines that is in best interest of estate **(ii)** on motion by Trustee **(iii)** w/i 120 days of order for relief **(iv)** after notice / hearing **(v)** and CR consents

- **iv) Limits on avoidance powers** – _____

➤ **A) SOL** –

- ⇒ **A) re filing of avoidance action** (§546(a)) - avoidance action m/b commenced by earlier of **(i)** later of **(a)** 2 yrs after entry for order for relief **or (b)** 1 yr after appointment of Trustee **or (ii)** close / dismissal of case

- ❖ applies to – strong arm (**A**), stat liens (**C**), fraudulent transfers (**E**), preferences (**F**), set off (**G**)

- ⇒ **B) re recovery of property / value** (§ 550) - recovery action m/b commenced by earlier of (i)

➤ **B) Delayed perfection allowed by state law** (§ 546(b)) – Bankruptcy Code respects where State law allows delayed perfection

- ❖ applies to – strong arm (**A**), stat liens (**C**), post-petition transfers (**D**)

- **C) Reclamation rights** (§ 546(c)) – Bankruptcy Code respects C/L right of CR to reclaim goods / offset amount due **IF (i)** sale was in ord course of sellers business + **(ii)** Debtor received goods while insolvent + **(iii)** CR demands reclamation by **(a)** 10 days after Debtor receives goods **or (b)** (if 10 day period expires after case commenced) → before 20 days after Debtor receives goods
 - ❖ applies to – strong arm (**A**), stat liens (**C**), post-petition transfers (**D**), preferences (**F**)
- **D) G/F transferees of initial transferee** (§ 550(b)) – Trustee may not recover from 2nd (or later) transferee IF 2nd transferee takes **(i)** for value (including satisfaction of antecedent debt) + **(ii)** in G/F + **(iii)** w/o knowledge of voidability of transferee
- **E) improvements by G/F transferee** (§ 550(d)) – G/F transferee retains lien on property **IFF (i)** transferee **improvements** increase value of property (not other appreciation to property) **and (ii)** in amount equal to lesser of **(a)** cost of any improvement less any profit realized to transferee from the property **or (b)** any increase to value of property from the improvement
 - ❖ **Improvements** – defined broadly (~ see 550(d)(2))
- **F) Asset sales w/i ordinary course of business** (§ 363) – DiP may sell assets w/o court approval if such transaction is in the **ordinary course of business**
 - ❖ **ordinary course of business** – transaction must meet both of the following - **In re Roth Am** (3rd 1992)
 - **i) horizontal test** - transaction m/b of the type regularly undertaken by businesses in the Debtor's industry
 - **ii) vertical test** (creditor's expectation) – transaction must not transaction subject the creditor to economic risk different from the risk the Creditor expected in extending credit

- **v) Recovery Amount** (§ 550) – _____

- **Amount** - depends on who has property
 - ⇒ **if property is in DiP / trustee possession** → lien merely avoided
 - ⇒ **if property is in transferee possession** → DiP / Trustee recovers either (i) property transferred **or (ii)** if court deems equitable - value of property (as of date of transfer / petition)
- **Paid by** – either **(i)** initial transferee **or (ii)** entity on whose behalf transfer was made **or (iii)** any immediate / mediate transferee of initial transferee

4. Creditor Rights -

- **A) Set Off (§ 542(b) / § 553)**

- see Ch. 2
- treated as secured claim
- consider impact of Automatic Stay
- limits –
 - **a)** debt m/b offsettable per C/L (b/c Code does not create right → merely allows non-bankruptcy right)
 - **b)** applies only re: allowed claims
 - ⇒ exception – disallowed property tax claim may be offset (§ 502(b)(3))
 - **c)** does not apply re: claim transferred to creditor either **(i)** post-petition **or (ii)** during 90days prior to petition while Debtor was insolvent (**NOTE**: insolvency presumed during 90 day period per § 553(c))-§553
 - ⇒ policy – prohibit trafficking in setoff rights
 - **d)** does not apply re debt owed to debtor if **(i)** incurred w/i 90 days before filing + **(ii)** while Debtor insolvent + **(iii)** for purpose of obtaining setoff (§ 553(a))
 - **e)** true preference rule (§ 553(b) - see Ch. 14

- right of setoff <> exercise of set off
 - right – survives filing + entitled to adequate protection
 - exercise – barred by automatic stay (§362(a)(7)) + allowed only w/ court order modifying auto stay
- limits
 - **automatic stay** – bar setoff where claim (owed to Debtor by CR) arose pre-petition – **see 3(G-2)(ii) above**

Debts owed to Debtor (§ 542(b))

Strumpf

• B) Other Remedies -

- **i) foreclosure (R/E) -**
- **ii) self help repossession of personalty -**
- **iii) replevin / detinue -**
- **iv) pre-judgment seizure -**
- **v) garnishment -**
- **vi) foreclosure sale of personal property -**
- **vii) non-regulatory state insolvency proceedings -**
- **viii) regulatory receivership -**
- **ix) cognovit / confession of judgment -**
- **x) composition / workouts -**

• C) Limits

- automatic stay -
- exemptions -
- cramdown -
- Lender liability – CR may be guilty of fraud if manipulates Debtor to disadvantage of other parties – State Nat'l Bank of El Paso v. Fara (TX App. 1984)
- Equitable Subordination -
- Ch. 11
 - DiP authorization
 - ⇒ ordinary course ops
 - ❖ granted = automatically (no court order necessary)
 - ❖ revoked – only w/ **(i)** request of party in interest + **(ii)** notice + **(iii)** opp t/b heard
 - ⇒ non-ordinary course ops / incurring secured debt = granted specifically by court

5. Financing Issues -

- **A) Operational Financing - see 6(C)**
- **B) Plan Financing**
- **C) Valuation Issues - see 2(C)**

6. Operating Debtor in Ch. 11

• A) Use, sale, Lease of property

- i) Authorization to run business (§ 1108) -
 - **generally** - DIP = immediately / automatically authorised to run business unless / until Trustee appointed
 - **limits** -
 - ⇒ **1) cash collateral**

Dynaco

- ❖ includes ~ cash equivalents in which entity other than DiP has interest (§ 363(a))
- ❖ DiP use requires - either (i) consent of other party w/ interest **or** (ii) court approval
 - ⇒ **2) pre-petition debts** -
- ii) Asset sales (§ 363(a)) – DiP may sell assets w/o court approval if such transaction is in the **ordinary course of business**
 - ❖ **ordinary course of business** – transaction must meet both of the following - **In re Roth Am** (3rd 1992)
 - i) horizontal test - transaction m/b of the type regularly undertaken by businesses in the Debtor's industry
 - ii) vertical test (creditor's expectation) – transaction must not transaction subject the creditor to economic risk different from the risk the Creditor expected in extending credit
- iii) O/S ordinary course of business -
 - § 363(b) sale –
 - ⇒ cannot dictate the material terms of a plan of reorg as part of a § 363(b) sale – **Braniff Airlines** (discussed in class)
 - ⇒ can sell assets per § 363(b) IFF has business purpose, considering 6 factors - **Lionel**
 - ❖ business reason (<> demands of unsecured C/C <> need for expedition)
 - B/C must specifically find that § 363 sale is in good faith - **Abbott Dairies**
- iv) judicial review standard = BJR

• B) Utility Service

- utility services (§ 366(b)) - cannot be cut for 20 days
 - Miller - courts read A/P requirement to require security deposit (or its equivalent)
 - **VA Electric & Power v. Calgor** = lead case
 - ⇒ D/C - granted utility § 503(b) administrative expense claim + streamlined procedure pursuant to which creditor could get immediate relief if any future default
 - ⇒ 2nd C/A – affirmed BUT narrower than D/C – determined that D/C can modify protection in appropriate circumstances to excuse the Debtor from the deposit / security requirement altogether + **adequate assurance does not necessarily require deposit**
- what about utility turning off service before bankruptcy – state laws may restrict + such action may precipitate the filing of Ch. 11

• C) Obtaining Credit

- **i) Procedure** (Rule 4001) – for other than § 364(a) financing **(i)** Debtor / lender must serve notice on CR Committee or 20 largest unsecured CR + **(ii) either (a) if consensual liens** --> **(x)** objections m/b raised w/i 15 days + **(y)** court either **(1)** may approve order w/o hearing if no objections **or (2)** if objections exist --> court must hold hearing w/ at least 5 days notice **OR (b) if non-consensual liens** --> **(x)** court conducts final hearing with at least 15 days notice
- **ii) Emergency relief** (Rule 4001(c)) – court may **(i)** conduct a preliminary hearing **and (ii)** grant interim approval to extent necessary to avoid immediate / irreparable harm
- **iii) Types of Financing**
 - **A) Cash Collateral** - see **6(A)(i)** above
 - **B) DiP Financing** -

⇒ **Debt safe harbor** (§ 364(e)) – loans per approved DiP financing remain valid despite a reversal on appeal **unless either (i)** credit extended in B/F **or (ii)** B/C **stays authorization** pending appeal **or (iii)** loan was not made for **legitimate purpose** under Bank Code **or (iv)** lender loans money after such reversal

⇒ **stays authorization** - CR must show **(i)** likelihood of success on appeal + **(ii)** irreparably harm absent a stay + **(iii)** harm to movant of not granting stay > than harm to other parties by granting stay + **(iv)** public interest not adversely affected by stay

⇒ **legitimate purpose** ~ if lender knows that loan for paying exp which w/n/b allowed in bankruptcy)– **In re EDC Holding** (7th 1982)

⇒ **1) unsecured debt (administrative exp)** (§ 364) –

- ❖ **requires** – debt is either **(a)** in **ordinary course of business** **or (b)** (if O/S ordinary course of business) be approved by a court for an **appropriate business purpose**
 - **ordinary course of business** ~ horizontal / creditor expectation tests (not usually payroll / operating exp)
 - **appropriate business purpose** – consider – does it benefit the estate
- ❖ **failure to meet requirement** –
 - **if equities support** → court may grant admin exp status retroactively – **In re City Wide Press** (ED PA 1990)
 - > **equities** – factors to consider include whether credit w/h/b approved if timely applied for + any harm to CR from granting priority + whether Debtor / CR believed debt was in ordinary course of business – **In re Braniff Airlines** (B ED NY 1994)
 - **if inequitable** --> lender not even recognized as unsecured debtor **In re Alafia** (Bank MD FL 1984)

⇒ **2) “favored” debt** (§ 364(c))

- ❖ **effect** – court may grant either **(i)** super-priority admin exp **or (ii)** lien on unsecured property **or (iii)** jr lien on secured property (~note jr. lienholder may seek foreclosure w/o sr. lienholder approval)
- ❖ **available only if** – **(i)** Debtor not able to obtain 364(a/b) financing
- ❖ **optional** – court may carve out of the 364(c) priority status for bankruptcy related fees

⇒ **3) secured debt (priming prior liens)** (§ 364(d))

- ❖ **A) available only if** – (i) Debtor **not able** to obtain 364(a/b/c) financing + (ii) DiP bears BoP showing **A/P** exists for pre-existing sr. / equal lien holder
 - **not able** – Debtor must undertake reasonable effort (~ usually w/l geographic area is sufficient)
 - **A/P** – **see 3(l)(ii) above**

❖ **B) valuation issues** –

– Possible methods –

- **a)** liquidation value - **In re Tenney Village** (B DNH 1989) +
- **b)** going concern value ~ where liquidation is unlikely – **In re Becker Indus.** (BSDNY 1986)
- **c)** interim level – **In re Phoenix Steel** (D Del 1984)
- **d)** “replacement value” – Ch 13 reorg where Debtor retains collateral for use in business - **Rash** (US 1997)

➤ **C) Cross collateralization** –

⇒ **Requires** – all of (i) business will not survive w/o proposed financing + (ii) no other alt financing available on acceptable terms + (iii) proposed lender will not accept less preferential terms + (iv) proposed financing is in best interests of the general CRs

⇒ **G/F** – lending to gain pre-petition security <> B/F – **In re Ellingsen** (6th 1987)

⇒ **types** -

- ❖ backward – secures post petition credit w/ pre-petition assets
- ❖ forward – secures both post / pre-petition credit w/ pre-petition assets

⇒ **Courts** -

- ❖ **11th** – forbidden – **Saybrook**
- ❖ **others** – accept backward cross collateralization

➤ **D) Rollover financing** –

➤ **E) Paydown financing** –

➤ **F) Return of Goods** (§ 546(g)) – allowed re: goods shipped prior to commencement of case **IF** all of (i) court determines (after notice / hearing) on (ii) motion of trustee + (iii) w/i 120 days of order for relief + (iv) that return is in best interests of Debtor + (v) and CR consents

- **iv) sources of financing** -

- **a) private equity** -
- **b) public equity** -
- **c) Institutional / private debt** -
- **d) high yield / junk debt** -

- **v) Forms of Financing** -

- Bonds = LT = secured by mtg = freely negotiable = registered (usually)
- Debentures = LT = unsecured
- Notes = ST
- Bank loans = ST = covenants limit BOD discretion
- Commercial Paper = ST = promissory notes
- Convertible securities = option (~ bond w/ warrant except conversion option is not separable)
- **Distressed debt** – yield ≥ 10% more than Treasuries

- **Multi-lender arrangements** -
 - ⇒ **Syndicated debt** – agent manages credit facility on behalf of syndicate members
 - ⇒ **Club arrangement** – Debtor K w/ each sr. lender + separate lenders may execute inter-creditor agreement limiting creditor rights
 - ⇒ Sr. Loan agreement w/ internal inter-creditor agreement –
 - ⇒ **Standstill agreement** – Sr. creditors agree to forbear exercising rights

- **D) Abandonment of Property**

7. The Plan

- **A) General Requirements**

- **i) time limits** – § 1121
 - ⇒ **1) filing plan** –
 - ❖ **A) exclusivity period** = 120 days from order for relief (extendable by court **for cause** after notice and hearing)
 - **for cause** – consider whether **(i)** Debtor diligently working towards Plan + **(ii)** there is potential for viable / successful business (considering value of business) + **(iii)**

Express One –

Purpose of bankruptcy <> to allow CR to take over Debtors
 Stands for – factors court looks at in determining extents
 Once terminated – anyone can file Plan

- ❖ **B) O/W** - no limit (but not exclusive to Debtor)
 - ⇒ **2) approving plan** = 180 days from order for relief (extendable by court for cause after notice and hearing)
 - **ii) who may file plan** -
 - ⇒ **1) Debtor** – exclusive right to file plan during exclusivity period
 - ⇒ **2) any other Party in Interest** – may file **IFF** either **(a)** trustee appointed **or (b)** Debtor not file plan w/i exclusivity period **or (c)** plan not accepted w/i period set by Code / Court (~ 180 days)
 - **iii) limits** – only limited by restrictions O/W applicable to K (B/F & Fraud)
 - **iv) modeled on** – C/L composition (~ all Cr. generally must agree)
 - **v) hurdles** – **(i)** secured creditors not interested in negotiating + **(ii)** apathy of unsecured creditors due to relative low discounted value of future recovery

- **B) Contents**

- **i) Explicitly required** – § 1123(a)

 - ⇒ **1) Debtor's designation of classes of claims / interests** – Code allows -
 - ❖ **a) explicitly for** - administrative ease **AND**
 - ❖ **b) practically IF** - all of following **(i)** creditors ultimately approve plan + **(ii)** each claim paid ≥ liquidation value + **(iii)** grouped claims = **substantially similar** (but no prohibition against separating similar claims) + **(iv)** plan designates classes and specifies specific treatment thereof + **(v)** equitable treatment w/i class (unless specific holder O/W agrees) + **(vi)** not **gerrymandering / bad faith** (§ 1122 / 1123)
 - **substantially similar** = having broadly same stake in proceeding & goals for reorg <> identical

- **gerrymandering / bad faith** – classification solely to win creditor approval – In re Greystone III (5th 1991)

⇒ **2) specification of unimpaired classes**

⇒ **3) specification and treatment of impaired claims / interests –**

- ❖ **impaired claims / interests** (§ 1124) – all classes / interests = assumed t/b impaired unless the Plan either -

- **a)** leaves legal, equitable, and K rights of holder unaltered **OR**
- **b)** cures defaults (except ipso facto defaults) + de-accelerates the obligation + compensates the holder for damages + does not O/W alter legal, equitable, and K rights of holder

⇒ **4) equal treatment of claims / interests w/i class**

⇒ **5) provision of adequate means for plan's implementation**

- ❖ **adequate means** – not defined in Code (e.g., rewriting charter to accommodate restructuring)

⇒ **6) if debtor = corporation** → appropriate amendment of charter

⇒ **7) any provisions to choose Dir/officer/etc.** → m/b consistent w/ int. of creditors / equity holders / public policy

⇒ **8) compliance w/ securities laws -**

- ❖ **a) federal exemption -**

- **from § 5 registration –**

- **§ 364(f)** – pre-empts all federal / state registration laws re: securities issued under § 364 **unless** either **(i)** security issued = equity **or** **(ii)** debtor = U/W
- **§ 1125 (e)** – no 10b-5 liability for solicitation of acceptance / rejection of Plan if Debtor issues Disclosure stmt in G/F
- **§ 1145 (a)** – available re exchange of existing debt **unless** Debtor is an U/W (NOT issuing debt securities to raise new funds)
- **SA § 4(2)** – placement of securities w/ limited number of sophisticated investors
- **SA 3(a)(9)** – exchange offer where no commission / other remuneration is paid
- **SA § 4(6)** – small offering (< \$5M) placed with accredited investors w/o solicitation

- **anti-fraud** – no exemption

- **Williams Act regulation of T/O** – no exemption

- **Proxy rules** – § 1145(a) exempts

- **SEA going private rules** - § 1145(a) exempts

- ❖ **b) state –**

- **registration rules** – pre-empted by § 364(f) / § 1145 (a) ??? – see above

- **anti-fraud rules** – no exemption

- ii) Mandatory for confirmation – _____

- ⇒ **1) re general unsecured debt** - plan must meet **best interests of creditors test** (§ 1129(a)(7))
 - ❖ **best interests of Creditor test** - all creditors not approving plan receive PV payments equal to the Ch. 7 liquidation value (~ cramdown does not help)
 - **limited exception** – applies if creditor made § 1111(b) election (see 2(G)(v)(c) above)
 - **cramdown** – does not mitigate this requirement
- ⇒ **2) re: priority unsecured debt** (§ 1129(a)(9)) – Plan conforms to following Priority requirements
 - ❖ **a) Group 1** – most favored status in plan
 - **consists of** - **Priority 1** (administrative claims) + **Priority 2** (involuntary “gap claims)
 - **requires** - each claim = entitled to immediate, full payment on effective date of plan (each claimant must approve / **no cram-down** allowed)
 - **exception** – if claimant accepts less favorable treatment
 - ❖ **b) Group 2**
 - **consists of** - **Priority 3** (wages) + **Priority 4** (employee benefits) + Priority 5 (grain elevators and fish processing facilities) + **Priority 6** (layaway deposits) + **Priority 7** (alimony, maintenance, support)
 - **requires** –
 - **A) each claim** = entitled to full payment on effective date of plan
 - **B) each class** = entitled to immediate payment
 - **effect** ~ class may accept deferred payment
 - > generally - if class does not accept Plan → Plan must provide cash payment of full immediate allowed claim on date Plan effective
 - > exception – if Plan accepted by **dual majority** of class → class may accept deferred payment of **full value** of allowed claim (~ PV of future consideration = allowed claim)
 - ◆ **dual majority** – see (C)(ii) below
 - ❖ **c) Group 3** – least favored
 - **consists of** - **Priority 8** (tax)
 - **requires** – full payment w/i 6 yrs of tax assessment (not immediate payment)
 - ❖ **d) Group 4** – no special treatment
 - **consists of** - **Priority 9** (bank bailouts)
- ⇒ **3) re: secured debt** –
 - ❖ each claim = own class (~ b/c not usually similar to other debt)
 - ❖ generally - plan must meet **best interests of creditors test** (§ 1129(a)(7))
 - **best interests of Creditor test** - all creditors not approving plan receive PV payments over course of plan ≥ Ch. 7 **liquidation value** (~ cramdown does not help)

- **liquidation value** = lesser of (i) amount of debt **or** (ii) value of collateral security
- effect – even if under-secured --> Debtor must pay interest on debt over the Plan
- ❖ exception – if CR makes § 1111(b) election (**see 3(G)(v)(c)(2)**) above) ~ > § 1129(a)(7) requires that CR receive nominal value of collateral as of Plan effective date

- **iii) Optional** (§ 1123(b) – **Key benefit = no S/H vote necessary** _____)

- ⇒ **1)** impair / leave unimpaired any class of secured / unsecured claims or interests
- ⇒ **2)** allow assumption / rejection / assignment of any executory K not previously rejected
- ⇒ **3)** allow for settlement / adjustment OR retention / enforcement of any claim / interest belonging to Debtor / estate
- ⇒ **4)** allow sale of all property of estate w/ distribution of proceeds to interest holders
- ⇒ **5)** modify the rights of holders of secured / unsecured claims **other than** those rights held re: claim secured only by interest in real property that = Debtor's principal residence
- ⇒ **6)** include any other appropriate provision not inconsistent w/ Ch. 11

• **C-1) Valuation in Confirmation –**

- Rule - collateral s/b valued to account for the debtor's use of the property (~ using replacement value (i.e.,)) - **Rash**
- Possible valuations – **Rash**
 - **a) replacement value** - the price a willing buyer in the Debtor's trade would pay to obtain property of like age and condition
 - **b) foreclosure value** – in going concern → is too low b/c it ignores the value associated with the proposed use of property (i.e., Creditor should share in increase in value associated (i) w/ going concern and (ii) fact that Creditor is unable to exercise its foreclosure right)

• **D) Confirmation –**

- **i) Disclosure / solicitation of confirmation** (§ 1125) – _____
 - **prohibition** – no **solicitation** of Plan approval / rejection is allowed until court approved Plan / written **disclosure stmt** is in place
 - ❖ **solicitation** – **Century Glove** (3rd 1988)
 - defined narrowly – 3rd circuit rejects any interpretation which would limit negotiation –
 - excludes submission of a draft Plan s/l/a Creditors vote is not requested
 - ❖ **disclosure stmt** – approved by court (i) after notice and opportunity for hearing if (ii) court determines it contains **adequate info** (~ sufficient to enable **reasonable investor typical of holders** in the relevant class to make an informed judgment)
 - **reasonable investor typical of holders** – investor who has (i) a claim / interest in relevant class + (ii) same type of relationship w/ Debtor as class generally has + (iii) same ability to gather info re: Debtor as class
 - ⇒ **policy** – need informed decisions
 - **limit of prohibition** – prohibition merely regulates the time period of solicitations of approval / rejection – it does not require court approval of other communications – **Century Glove**
 - **met by** - concurrent / prior delivery of both (i) copy / summary of Plan + (ii) approved written disclosure stmt
 - different disclosure (to different classes) = allowed (IF all w/i same class receive same) – § 1125(c)

- **ii) Voting** (§ 1126) – _____
 - **a) who votes** – by claim (not claimant)
 - ⇒ **1) impaired classes** – YES - each impaired class of CR and S/H votes
 - ❖ impaired claims / interests (§ 1124) – all classes / interests = assumed t/b impaired unless the Plan either –
 - a) leaves legal, equitable, and K rights of holder unaltered OR
 - > **unaltered** – no change allowed (not even if “better” treatment)
 - b) cures defaults (except ipso facto defaults) + de-accelerates the obligation + compensates the holder for damages (~ including K damages in form of default interest) + does not O/W alter legal, equitable, and K rights of holder
 - ⇒ **2) unimpaired classes** – **NO** - deemed to have accepted the plan
 - **b) vote required** - not unanimous
 - ⇒ **1) generally** – **dual majority** ~ both of following
 - ❖ **a) majority of claims (>50%)** - **in each class** must approve **(not amount voting) AND**
 - ❖ **b) 2/3 super majority of amount (≥ 2/3)**– **in each class** must approve **(not amount voting)**
 - ⇒ **2) exceptions**
 - ❖ **A) cramdown** – **see iii(8)(B) below**
 - ❖ **B) pre-packaged Plans** – **IF (i)** Holder accepted / rejected Plan **(ii)** prior to commencement of case --> Holder is deemed to similarly accept / reject **IF (iii) either (a)** solicitation of acceptance / regulation = in compliance w/ any applicable non-bankruptcy, law / rule / reg **or (b) (default)** solicitation followed disclosure of adequate info
 - **c) Disqualification** – court may **(i)** disqualify the vote cast if **(ii)** party in interest requests and **(iii)** only after notice and opportunity for hearing and **(iv)** court finds that claimant / interest holder received special treatment – § 1126(e)
 - **d) Policy** -
 - ⇒ **voting requirements** – prevent Plan acceptance by few large CR over objection of many small CR + vice versa
- **iii) Requires** – notice + actual hearing + all of following (§ 1129) _____
 - ⇒ **1) Plan compliance** w/ all Bankruptcy Code provisions (e.g., all mandatory provisions outlined above)
 - ⇒ **2) Proponent of Plan** (~ DiP) complies w/ all Bankruptcy Code provisions
 - ⇒ **3) G/F** - plan proposed in G/F and w/o violating any state/ federal law (BUT probably excludes misconduct in process of obtaining acceptances)
 - ⇒ **4) Court approves costs** related to admin of bankruptcy
 - ⇒ **5) Plan proponent discloses** – **(i)** identity / affiliations of Dir / off / voting trustees of Debtor + **(ii)** any Debtor affiliate participating in jt. plan of reorg + **(iii)** any successor to debtor under the plan
 - ❖ appointments under plan – m/b consistent w/ interests of CR / S/H / P/P

- ⇒ **6) regulatory approval** - obtained or plan conditioned on approval (as necessary depending on industry)
- ⇒ **7) Best interest of creditors** test met (**see 7(B)(ii)(1)**) – subject to § 1111(b) exception (see
- ⇒ **8) CR Approval** – either by

❖ **A) classes of claims / interests** – § 1129(a)(8) **OR**

- **vote** = by **impaired classes** only (unimpaired classes <> vote) –
 - **impaired class** (§ 1124) –
 - > **includes** - all classes = impaired unless the Plan **either**
 - ◆ **i)** leaves legal / equitable / K rights of holder of claim / interest unaltered **OR**
 - ◆ **ii) all of (a) cures defaults + (b) de-accelerates obligation + (c) compensates holder for dmgs + (d) O/W does not alter holder's legal / equitable / K rights**
 - > **judicial right of foreclosure created by default** – **In re Madison Hotel Associates** (7th 1984) – not allowed (and CR not impaired) if Plan cures / compensates / not otherwise alter rights
 - **requisite approval** = dual majority - **see 7(C)(ii) above**

❖ **B) Court approved Cramdown** (§ 1129(b)) –

- **requires** - **all** of following -
 - **i) Proponent requests cramdown +**
 - **ii) at least one class of impaired claims approves** (ignoring votes of insiders)
 - ~ **if any such claims exists** - § 1129(a)(10)
 - > **effect** - prevents Plan confirmation if all CR reject + barrier in single asset reorg
 - **iii) Plan does not discriminate unfairly** ~ claims w/i each class = treated same
 - **iv) Plan is **fair and equitable**** to classes (equal to and below) the highest class which **both (i) dissent + (ii) are impaired**
 - > **fair and equitable** (§ 1129(b)(2)(A-C)) ~ Absolute Priority Rule

◆ **on appeal** - C/A will consider "F & E" of the Plan as a whole (will not consider merits of a single issue) → Test = whether terms of Plan fall w/ range of reasonable litigation possibilities - **Barry v. Smith (NY NH RR)** (2nd 1980)

- ◆ **A) for secured CR** – Plan provides to each class **either**
 - i) retention of lien (or lien in subst prop) + full payment of secured claims** (~ PV of payments as of Plan effective date = allowed amount of CR secured claim excluding equity cushion) **OR**
 - ii) sale of property + attachment of lien to proceeds** **OR**
 - iii) indubitable equivalent** ~ reference A/P **at 3(I) above**

- ◆ **B) for unsecured CR** – Plan provides each claim either
 - i) property w/ value as of effective date = allowed amount of claim (100% recovery) **OR**
 - ii) no holder of any jr claim / interest receive / retain property **on account of** such jr. claim / interest
 - **on account of** – means “because of” – **BofA v. 203 N. LaSalle** (US 1999)

- ◆ **C) for equity interests** – Plan provides each holder -
 - i) property w/ value as of effective date = greatest allowed **fixed liquidation preference** / fixed redemption price to which holder entitled
 - **fixed liquidation preference** - ???
 - ii) no holder of any jr interest receive / retain property as result of such jr. claim / interest

> New Value “exception” – relevant issues include

- ◆ **1) How s/b treated?** – exception from rule v. purchase of new equity
- ◆ **2) Required** (under C/L interpret of Bank Act) - contribution m/b **(i) new + (ii) necessary + (iii) substantial** in comparison to pre-petition claims + **(iv)** reasonably equivalent to value of ownership interest received + **(v) money or money’s worth**
 - **necessary** – difficult to comply w/ b/c must show that no other investor can be found on similar or better offer
 - **money or money’s worth** ~ liquid assets (not guarantees)
- ◆ **3) Does Exception / Corollary exist under Bank Act?** – unclear b/c S/C refuses to clarify
- ◆ **4) Sufficiency of value** –
 - **market test** – some effort m/b made to determine true market value - **BofA v. 203 N. LaSalle** (US 1999) ~ not if old equity is allowed exclusive participation
 - > unclear if expert valuation is sufficient (w/o competitive bidding)
 - > Bankruptcy Judges <> qualified to do valuations
 - **Sweat equity** <> sufficient – **North Worthington v. Ahlers** (US 1988)

- ◆ **4) policy** - need heightened judicial review to counter problems re: selling to insiders

> effect of fair and equitable / APR –

- ◆ **S/H** - get nothing b/c equity comes last
- ◆ **secured CR** - minimal b/c similar to **best int of CR** test

↪ **policy** – promotes goal of achieving reorg over goal of CR / DR agreement

- ⇒ **9) Priority claims** provided w/ full payment on effective date of Plan – **see 7(B)(ii)(2)**
- ⇒ **10) approval by at least one impaired class** (if any exist) – ignoring insiders in such class (for vote / but not for denominator (~size of class))
- ⇒ **11) Plan = feasible** – (i.e., Debtor w/b likely to avoid liquidation, unless Plan specifically so provides)
 - ❖ policy – prevent repeated reorgs → Debtor should solve problems on first try + weed out no-hopers
 - ❖ in practice – if no one objects → B Judge has no choice but to sign order authorizing Plan
- ⇒ **12) Bankruptcy fees paid** (or t/b paid by effective date of plan)
- ⇒ **13) § 1114 retirement benes** = provided for

• **E) Modification of Confirmed Plan**

- Proposal made by – either **(a)** Proponent **or (b)** reorganized Debtor
- When – m/b before substantial consummation of Plan
- Requires – all of following
 - **i)** modified Plan must meet all requirements of § 1122 + § 1123 (**see 7(B) above**)
 - **ii)** circumstances warrant
 - **iii)** court confirms modified PL after notice and opportunity for hearing – § 1127(b)
- Vote – Court assumes all parties vote same (as for original Plan) unless notify Court O/W w/i time set by court

• **F) Post Confirmation Matters**

- **i) Effect of confirmation** (§ 1141) = **(i)** binds all parties in interest + **(ii)** re-vests property of Estate in Debtor (unless Plan O/W provides) + **(iii) discharge** granted (differs from Ch 12/13)
 - **discharge** – pre confirmation claims / interests = replaced by claims / interests under Plan - **See 8 below**
- **ii) Implementation of Plan** = responsibility of reorganized Debtor

• **G) Revocation of Confirmation –**

- requires - all of following **(i)** request of party in interest + **(ii)** made w/i 180 days of confirmation order + **(iii)** after notice / opportunity for hearing + **(iv)** court finds confirmation was procured by fraud + **(v)** court revokes Debtor's discharge – § 1144
- policy – need for finality

8. Discharge

• A) Effect of Ch. 11 Discharge

- i) Property of estate = revested in Debtor
- ii) Prop dealt w/ in Plan = free and clear of all claims / interests **except** as O/W dealt w/ in Plan
- iii) order of confirmation = discharge / injunction

• B) Revocation of Discharge

- **Requires** – (i) PL show Plan procured by Fraud + (ii) revocation sought w/i 180 days of confirmation

• C) Denial of Discharge

- occurs when -

- **Ch. 11** – either

- ⇒ **1)** court does not confirm a plan (for any reason) **OR**
- ⇒ **2)** all of (i) plan provides for liquidation of substantially all property + (ii) Debtor <> engage in business after plan consummation + (iii) if case h/b under Ch. 7 → discharge w/h/b denied per **§ 727(a)** [§ 1141(d)(3)]

❖ **§ 727(a)** – lists 10 bases for denying relief in Ch. 7 largely related to Debtor misbehavior

- effect = no debts are discharged

• D) Non-Dischargeable Debts (§ 523)

- general considerations –

- i) liens – always survive discharge

- **issue** = lien stripping

- ⇒ = Debtor sells property, pays off lien, and keeps excess
- ⇒ not allowed b/c lien survives discharge

- ii) taxes – including loans taken to pay non-dischargeable tax obligations

- iii) debts arising from Debtor's fraudulent actions -

- **requires** – material falsity (minor errors = ignored)

- **includes** – either -

- ⇒ **1) any of (i)** false pretenses **or (ii)** false representations **or (iii)** actual fraud **OR**

- ⇒ **2) re: financial statement** - where false representation of financial condition in written stmt **IF (a)** creditor reasonably relied on + **(b)** Debtor caused it t/b made / published w/ intent to deceive + **(c)** materially false

- iv) unscheduled debts -

- v) fraud by fiduciary – debts arising while Debtor operating in Fiduciary capacity

- vi) alimony, maintenance, support, et al -

- vii) intentional torts -

- viii) finances, penalties, forfeitures -

- ix) educational loans -

- x) DUI debts -
- xi) debts undischarged in prior proceedings -
- xii) fraud on depository institutions -
- xiii) failure to maintain capital requirements -
- **E) Discharge Waived (§ 1141(d)(4))**
 - occurs if – waiver is **(i)** in writing + **(ii)** executed by Debtor after order for relief + **(iii)** approved by court
- **F) 3rd Party non-Debtor Discharge**
 - i) Is it allowed – depends on circuit
 - 9th / 10th – absolutely prohibited by § 524(e)
 - 2nd / 4th - release allowed under § 105 equitable power **IFF (i)** claims = widespread (~ mass torts) + **(ii)** enjoined parties = compensated + **(iii)** discharge needed for reorg
 - 11th - release allowed under § 105 equitable power **IFF (i)** release = integral to reorg + **(ii)** injunction against PL w/b fair and equitable
 - **Miller** – if allowed → release allowed under § 105 equitable power **IFF (i)** tangible consideration given by releasee's for the benefit of CR / reorg + **(ii)** m/b an affirmative stmt by releasing CR allowing release
 - 3rd – Def fails b/c does not satisfy any test (~ do not create new test / choose b/w existing tests if present tests are sufficient) - **Continental Airlines** (3rd 2000)
 - ii) policy
 - **against release** - if you want the benefits of Bankruptcy → you should file Bankruptcy
 - **for release** –
 - ⇒ to extent DiP can exercise claim of CR → this is property of estate and a proper subject of the Plan
 - ⇒ claims which are derivative → certain situations allow CR (in the name of DR) to sue Def