



BANKRUPTCY LAW SECTION
STATE BAR OF TEXAS

30 Things to Consider Before You File a Chapter 11 Petition



STREUSAND | LANDON

OZBURN | LEMMON LLP

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Greg Milligan, CTP

Executive Vice President
Harney Partners



Sabrina L. Streusand, Partner
Streusand, Landon, Ozburn and
Lemmon, LLP



Erik White, CIRA

Managing Director
Harney Partners



Anh Nguyen, Attorney
Streusand, Landon, Ozburn and
Lemmon, LLP



Overview



Case Strategy

1. What's the Win?
2. Alternatives to Chapter 11
3. Subchapter V Considerations
4. Where to File?
5. Plan Considerations



Preparedness

6. Authority to File
7. Fiduciary Duties
8. Zone of Insolvency
9. Receptiveness to Judicially-Supervised Negotiation Process
10. Management & Employees
11. Duties to Report
12. Communication Strategy
13. Potential Issues for Publicly Traded Companies
14. Retention of Professionals
15. Is the Debtor Ready to be a Debtor-in-Possession?
16. Funding the Chapter 11 Process? (Overall Liquidity)
17. Funding the Chapter 11 process? (Specific Payments)



Operations

18. Implications on Supply Chain
19. Analysis of Assets
20. Analysis of Claims
21. Analysis of Litigation
22. Impact on Contracts and Other Agreements
23. Real/Personal Property Leases
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25. Customer Relations
26. Impact on Letters of Credit and Other Outstanding Obligations
27. Potential Preferences
28. Potential Fraudulent Transfers
29. Credit Bid Rights
30. COVID Considerations

1 What's the win? What is the goal of the Chapter 11 filing?

- a. Must have a specific benefit to be gained from a Chapter 11 filing; otherwise, find a different way or different venue to get it done.
- b. The exit strategy is most important. Start there and work backward to the filing. (For example, merely stopping a foreclosure sale is not sufficient.)
- c. What alternatives have been pursued already?
- d. Examples of an exit strategy: (Run parallel paths; no time to double back)
 - i. Operational – Is there a core profitable business to reorganize around?
 - ii. Recapitalization – New debt, new equity, refinance for better terms
 - iii. Sale under §363 – Stalking horse to set floor and provide confidence
- e. Liquidation analysis to measure against other alternatives; update as circumstances change
- f. Speed of execution is critical given cost of Chapter 11. Do as much as possible before filing.

2 Alternatives to Chapter 11

- a. Assignment for the Benefit of Creditors
- b. Receivership
- c. Chapter 7
- d. Subchapter V
- e. Out-of-Court Options
 - i. Refinance
 - ii. Sale
 - iii. Merger

Note: A thorough review of available alternatives will determine whether Chapter 11 is the best option.

3 Considerations for Subchapter V Filing

- a. Eligibility and Debt Threshold
- b. Speed
- c. More Affordable
- d. Confirmation May Be More Likely
 - i. Absolute Priority Rule
- e. Maintaining Control
- f. No Creditors Committee

4 Where to file?

- a. 28 U.S.C. § 1408 provides that bankruptcy case may be commenced in the district containing the debtor's domicile, residence, principal place of business . . . or principal assets in the United States . . . for the one hundred and eighty days immediately preceding the filing of the case.
- b. 28 U.S.C. § 1412 – Transfer of Venue for “Convenience of the Parties” factors:
 - i. Proximity of creditors of every kind to the court
 - ii. Proximity of the debtor to the court
 - iii. Proximity of the witnesses necessary to the administration of the estate
 - iv. Location of the assets
 - v. Economic administration of the estate
 - vi. Necessity for ancillary administration if bankruptcy should result
- c. *In re Volkswagen of America, Inc.*, 545 F.3d 304 (5th Cir. 2008) – Private and Public Interest Factors Considered Under 28 U.S.C. § 1404(a).

5 Plan Considerations

- a. Claims classifications
- b. Absolute priority rule
- c. Cram down - 1111(b) election
- d. Solicitation
- e. Exit Financing
- f. Post-Confirmation Trust

6 Authority to File

- a. Who is the client and does the person in your conference room have authority to act for the entity, and, if not, how do you get there?
- b. Articles of Incorporation, bylaws and organizational documents.
- c. Is there anything in the governance documents that restricts a filing?
- d. Are there stock pledges or lending agreements that impact authority?

7 Can the Debtor-in-Possession perform as fiduciary?

The new role as a fiduciary means:

- a. No insider loans
- b. No self-dealing
- c. Disclosure of any “connections” and potential conflicts of interest
- d. Board of Directors has duties to creditors and shareholders/interest owners
- e. “Macy’s Window” – New level of transparency and public scrutiny

8 Zone of Insolvency

- a. Expansion of fiduciary duties.
- b. Distinction between company's counsel and owner's personal counsel – perhaps for the first time.
- c. Effect of filing on personal guarantees

9 Is the client receptive to a judicially-supervised negotiation process?

- a. The client needs to understand that anything outside the “ordinary course” of business will generally require a motion and a hearing.
- b. Demand on management team's time will be higher with less time to focus solely on the business.
- c. Generally, lots of activity the first 90 days, then less activity during the middle stage of the case, followed by lots more activity around filing Plan and Disclosure Statement ... and hopefully confirmation.

10 Is management prepared and can key employees be retained?

- a. New life in a fishbowl
 - i. public disclosure
 - ii. second guessing
 - iii. potential committee
 - iv. UST standing

- b. What will it take to keep key employees at their jobs?
 - i. How mobile are key employees?
 - ii. Are KERP's necessary/available?
 - iii. Potential for pre-petition bonus vs. post-petition payment?
 - iv. Is there D&O insurance?

- c. What is anticipated timeline for case?
 - i. First 90 days
 - ii. Last 90 days
 - iii. Slower in the middle

11 Duties to Report

- a. Schedules
- b. Statement of Financial Affairs
- c. Initial Report to US Trustee
 - i. Bank accounts
 - ii. Insurance statements
 - iii. 90-day profit and loss statement
 - iv. Federal income tax returns for previous 3 years
 - v. Sales tax returns for previous 3 months
 - vi. Financial statements
- d. Monthly Operating Reports
- e. Form 426 – Controlling interests in non-debtor entities
- f. Lender reporting requirements

12 What is your communication strategy?

- a. What is the messaging for?
 - i. Employees
 - ii. Vendors
 - iii. Customers
 - iv. Other constituencies, including the press
- b. Assign a point person to manage each constituent group to insure accurate and consistent information is being provided.
- c. Information must be timely. Return calls within 24 hours. If you're not communicating, the other party assumes you're plotting against their interests.
- d. Consider issuing FAQ's or establishing special website or call center to update and control the messaging.

13**Potential Issues for Publicly Traded Companies**

- a. Potential delisting
- b. Increased scrutiny
- c. SEC reporting
- d. Potential motion re: stock trading

14**Retention of Professionals**

- a. Bankruptcy counsel
- b. Financial/restructuring advisors
 - i. Financial Advisor
 - ii. Chief Restructuring Officer (CRO)
 - iii. Other interim management roles
 - iv. Independent Board Member
- c. Counsel working on special projects for Debtor
- d. Outside Accountants and Tax Preparers
- e. Valuation Experts
- f. Investment Bankers
- g. Public Relations Specialists

15 Financial operation: Is the Debtor ready or can it be made ready?

- a. Even more so, "cash is king"
 - Efforts are laser focused on maximizing cash collections and limiting cash disbursements;
 - If you can't cash flow in Chapter 11, you won't be in Chapter 11 long
- b. Accuracy and timeliness of reporting
- c. How robust are pre-petition projections or will you be starting from scratch?
- d. Need to implement new protocol to segregate pre- and post-petition A/P
- e. Depending upon the DIP financing, might also have to segregation collateral proceeds
- f. Are there any formal or informal valuations prepared? Know what they are because they might help or hurt your position in the case.

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Can the potential Debtor fund the Chapter 11 process? (Overall Liquidity)

- a. Chapter 11 does not create liquidity
- b. Is there sufficient cash collateral to fund the Debtor's operations?
- c. What is the status of bank accounts? Is there a lock box or other arrangement under secured lender's control?
- d. Will the secured lender agree to Debtor-in-Possession funding? Is third-party DIP financing available? Is the information necessary to obtain third-party financing assembled and/or how much time will that take to assemble and obtain financing?

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Can the potential Debtor fund the Chapter 11 process? (Specific Payments)

- a. Retainers (Carve-out available?)
- b. U.S. Trustee fees
- c. Security deposits
- d. Post-petition obligations must remain current, including, but not limited to, the following:
 - i. Wages
 - ii. FICA, federal and state employment taxes
 - iii. Taxes (sales, real property, personal property, etc.)
 - iv. Deposits for withheld wages
 - v. Rents

18 Implications on Supply Chain

- a. What impact would the Chapter 11 filing have on suppliers?
- b. Any sole source suppliers that need special attention
 - i. Pre-petition payments and arrangements
 - ii. Post-petition critical vendor approval
- c. Potential liens by warehousemen and freight providers
- d. Executory contracts?
- e. Foreign vs. domestic?
- f. Reclamation rights for goods received within 45 days of the Petition Date - § 546(c)
- g. Administrative expense status for goods received within 20 days of the Petition Date - § 503(b)(9)

19 Analysis of Assets

- a. Current market valuation
- b. Secured claims
- c. Costs of sale
- d. Insurance
- e. Special considerations
 - i. Intellectual property and other intangible assets
 - ii. Restrictions on anti-assignment clause transfers

20 Analysis of Claims

- a. Secured creditors – perfection issue
 - i. Run a lien search
 - ii. Run a UCC-1 search
 - iii. Value collateral
 - b. Statutory lienholders
 - c. Vendors
 - d. General unsecured creditors
- How many creditors in each category to negotiate with?
Answer will impact solicitation plan.
- e. Special interests claims
 - i. PACA
 - ii. Retiree claims
 - iii. Aircraft loans and leases §1110
 - iv. Reclamation / administrative claims
 - v. ERISA
 - vi. Tax
 - vii. Environmental, FDIC, SBA
 - viii. Landlords
 - ix. Insiders

21 Analysis of Litigation

- a. What litigation is the client bringing or defending?
- b. Which of these can or should be removed to Bankruptcy Court if a Chapter 11 is filed?
- c. What insurance policies, if any, cover these claims?

22 Chapter 11 filing and the impact it may have on other agreements

- a. Review of executory contracts and unexpired leases
- b. Bad Boy and Springing Guaranty
- c. Are there make-whole provisions
- d. Forward contracts. Exceptions to automatic stay under §546(e)

23 Real and Personal Property Leases

Real Property Leases

- a. Cure defaults
- b. Provide adequate assurance of future performance by 120th day of the case
- c. Reject of burdensome leases

Personal Property Leases

- a. Status
- b. Payment commences on day 60
- c. Proof of insurance

24 Critical Vendor Issues and Motion Practice

- a. Cost to get critical vendors and/or supplies to perform
- b. Proof of essential nature to client
- c. Pre-petition planning
- d. Leverage and risk with sole-sourced vendors

25 Customer Reactions

- a. Warranties
- b. Programs to reward buyer's loyalty
Example: Assumption or rejection of frequent flier miles
- c. Impact on sales – Will a bankruptcy filing deter consumers from continuing to purchase from the Debtor? [Critical concern for some companies, such as with the auto bankruptcies in 2008/2009 due to warranty and maintenance considerations for high-dollar consumer items.]

26 Impact on Letters of Credit and other outstanding obligations?

- a. No injunctions for criminal actions.
- b. Guarantor actions – generally not stayed.
- c. General partners' liability for partnership debts.
- d. Personal liability of officers and directors for unpaid trust fund type taxes.
- e. Personal liability of officers and directors in class action or securities lawsuits.
 - i. Injunction relief may be available for officers and/or directors if covered by the Client's insurance policies.
 - ii. Copies of insurance policies need to be reviewed.
- f. Any involvement with EPA, U.S. Department of Health and Human Services, and other regulatory public interest agencies? These will generally not be stayed.

27 Potential Preferences

- a. Allows a debtor/trustee to recover certain transfers made prior to the bankruptcy filing
- b. Elements: (1) a transfer; (2) of property of the debtor; (3) to or for the benefit of a creditor; (4) for or on account of an antecedent debt; (5) made while the debtor was insolvent; (6) made during the preference period of 90 days or one year for insiders; and (7) that enables the creditor to receive more than it would have received in a hypothetical Chapter 7 liquidation

28 Potential Fraudulent Transfers

- a. A transfer of the debtor's assets to a third party with the intent to prevent creditors from reaching the assets to satisfy their claims
- b. Debtor/trustee seeks to recover money paid within 2 years of the bankruptcy filing due to: (1) actual fraud; or (2) because the debtor received less than adequate consideration for the transfer
- c. A transfer for less than a reasonable equivalent value in exchange for such transfer or obligation and made while the debtor was insolvent or for which the debtor became insolvent as a result of the transfer.

29 Right of the Secured Party to Credit Bid under §363(k)

- a. Have agreement or determination prior to process.
- b. If conducting an auction, do it in the courtroom in the presence of the Court or use a videographer or court reporter to create a record.

30 COVID Considerations

- a. Debtors may seek Court approval to apply for PPP loan
- b. Contractual provisions and applicable non-bankruptcy law that prohibit a debtor from incurring additional debt are void with respect to PPP loans
- c. PPP loans obtained after a bankruptcy filing are entitled to administrative payment priority. Subchapter V debtors may repay over time according to the terms of the loan.
- d. Certain late rent and vendor payments made in accordance with forbearance agreements that debtors executed with landlords or vendors after March 13, 2020, for amounts due before March 13, 2020, are now exempt from preference avoidance; however, late charges and interest payments remain subject to avoidance as preferences if they are more than a debtor would have incurred if the debtor had made all of its payments in a timely manner.
- e. Utility companies are prohibited from terminating service for individual debtors who cannot provide adequate assurance of payment if the debtor comes current on his or her debt to the utility company during the first 20 days of the bankruptcy case and remains current thereafter.
- f. Recent modifications to the Bankruptcy Code sunset after one year, except for the provisions related to PPP loans, lease payments by subchapter V debtors, and preference avoidance, which will sunset after two years but continue to apply to all cases filed before the second anniversary of the enactment of the bill

