

THE BASICS OF CHAPTER 11 BANKRUPTCY

Bankruptcy is a legal proceeding in which a debtor declares an inability to pay consumer or business debts as they become due. Debtors may seek to be excused from continuing liability for the debts, or they may request time to arrange their finances.

Chapter 11 refers to the provisions in the Federal Bankruptcy Code for court-supervised reorganization of debtor companies. A company files for Chapter 11 protection when it can no longer pay its creditors or when it foresees future liabilities it cannot hope to pay, such as product liability damage awards.

Chapter 11 Basics:

1. Chapter 11 Bankruptcy filing imposes an automatic stay.
 - Creditors generally cannot file or continue suits for repayment.
 - Debts are frozen and creditors generally must stop collection actions. This is called the "automatic stay."
 - Debtor's day-to-day operations continue.
 - Spending, borrowing, and asset sales outside of the debtor's normal course of business must be approved by the court.
 - Secured creditors can ask the court for exemption from the automatic stay to undertake or continue to recover the collateral that secures their claim.

2. Unsecured creditors form a committee.
 - The U.S. trustee, a federal officer supervised by the court, appoints the committee, which ordinarily consists of the seven largest unsecured creditors who are willing to serve on the panel.
 - The U.S. trustee can appoint additional committees to represent other creditors and shareholders.
 - The committee chooses representatives to deal with the debtor company.
 - The committee and U.S. trustee oversee the debtor's business operations.
 - Creditors and the U.S. trustee can ask the court to appoint an examiner to investigate possible fraud or mismanagement.
 - Creditors and the U.S. trustee can ask the court to order the appointment of a case trustee to run the debtor company.
 - If the court orders the appointment, the U.S. trustee selects the case trustee unless a party asks that creditors be allowed to elect the case trustee.

3. The committee, other creditors, and the debtor company negotiate a reorganization plan.
 - Only the debtor can file a reorganization plan with the court for the first 120 days of the bankruptcy case. The court can extend the so-called "exclusivity" period and often does so, but in no event may the exclusivity period, including all extensions, be longer than 18 months.
 - If the debtor does not file a plan during the exclusivity period, if the court does not approve the debtor's plan, or if a trustee is appointed, any party can file a plan.
4. Creditors and shareholders vote on the plan.
 - Only creditors and shareholders whose claims and interests are impaired or affected by the plan vote on it.
 - A class of creditors accepts the plan if creditors who hold more than half of the claims in the class approve the plan by number and at least two-thirds of the claims by amount.
 - A class of shareholders accepts the plan if the plan is approved by shareholders that hold at least two-thirds of the equity interest in the class by amount.
5. Judge considers the plan.
 - The bankruptcy judge approves the plan if it complies with the Bankruptcy Code and all impaired classes approve.
 - If at least one of the impaired classes approves the plan and it meets certain statutory tests, the judge can confirm the plan in a so-called "cramdown" even if not all impaired classes approve.
6. Reorganized company emerges.
 - Generally, the debtor's debts are discharged.
 - The debtor and creditors must comply with the confirmed plan.
 - The automatic stay ends and a permanent injunction goes into effect against any effort to collect pre-petition debts other than as provided in the plan.
 - The reorganized debtor operates like a normal company.

GLOSSARY OF CHAPTER 11 TERMS

Adequate Information: Information pertaining to the debtor that enables a creditor or other holder of claims to make an informed judgment about the bankruptcy plan.

Agent Bank: The bank handling all administrative functions associated with bank loans to a company.

Automatic Stay: The bankruptcy petition filed by the debtor automatically pauses or suspends (stays) virtually any litigation or creditor action that would be detrimental to the company.

Balance Sheet Insolvency: When a company's debts exceed the fair market value of its assets.

Bankruptcy: The step taken by a business in financial crisis. It allows the U. S. Bankruptcy Court to halt all actions and claims against the filing company. A Chapter 11 bankruptcy usually leads to reorganization.

Case: The entire administrative procedure in which administration and litigation proceedings take place.

Chapter 7: Chapter 7 of the Bankruptcy Code is entitled "Liquidation." Under Chapter 7, the trustee collects the property of the debtor, converts that property to cash, and distributes the cash to the creditors.

Chapter 11: Chapter 11 generally deals with debtor rehabilitation or reorganization – not liquidation of a debtor's assets. In a Chapter 11 case, the debtor retains its assets and makes payments (usually from post-petition earnings) to creditors according to a court approved plan.

Chapter 11 Trustee: The Chapter 11 Trustee manages the reorganization process under the Court's supervision.

Claim: The right to payment or reimbursement for breach of performance, if such a violation gives right to payment.

Class: A grouping of claims or interest that are similar to each other. Classification is based on the priority of state law, nature of collateral, and agreement among creditors.

Creditor: An individual or business entity that has a claim for payment or services.

Creditors Committee: A committee formed by the Bankruptcy Court, including representatives of the filing company's unsecured creditors. The creditor's committee negotiates with the filing company through the court on behalf of, and in the best interests of, the entire class of unsecured creditors.

Debt: A valid and enforceable obligation to pay fixed or determinable sum of money.

Debtor: The person or entity that files the petition that begins the bankruptcy case.

Debtor-in-Possession (DIP): Another name for the company while it is permitted by the court to continue to manage and operate its business during the Chapter 11 process.

Discontinued Operations: An entire business subdivision that is no longer used (i.e. a closed store).

Disinterested Person: One who is not related to an insider, creditor or equity holder of the corporation, and does not have an interest materially adverse to the interest of the corporation or any class of creditors or equity security holders.

Emerging Entity: Entity that has emerged from Chapter 11 under a confirmed plan.

Fair Market Value: The amount at which property would change hands between a willing buyer and a willing seller.

Leveraged Company: A company that has interest-bearing debt.

Liquidation Value: The value of a business or of an asset when it is sold under financial distress.

Liquidity: A firm's ability to meet its short-term financial obligations.

Net Operation Loss (NOL): The amount by which a corporation's operating expenses exceed its gross income.

Person: Under the Bankruptcy Code, an individual, partnership, or corporation, but not a governmental unit.

Plan of Reorganization: The document produced through negotiations with creditors and equity holders that, when approved, is the end product of the Chapter 11 legal process. The plan describes the terms and conditions for continuation of the debtor's business, and the terms of payment to creditors and stakeholders.

Pre-petition: Rights and obligations of the debtor in bankruptcy that occur before the filing date of the debtor's bankruptcy petition are described as "post-petition."

Post-petition: Rights and obligations of the debtor in bankruptcy that occur after the filing date of the debtor's bankruptcy petition are described as "post-petition."

Preference of Preferential Payment: Any legitimate and proper transfer or payment made by the debtor while insolvent, within 90 days (one year for insiders), prior to the filing of the bankruptcy petition, and in payment of valid debt, when the effect of the payment was to cause one creditor to receive a greater percentage of debt than would have been received of the debtor were liquidated under a Chapter 7 proceeding. Such transfer or payment is deemed to belong to the estate and may be recovered.

Related Party: An affiliated company, principal owner, management (and members of their immediate families), entities accounted for by the equity method, or any other party that can influence the management or operating policies of the firm to the extent that one party might be prevented from fully pursuing its own separate interests.

Reorganization: The process by which a business restructures, via obtaining different financing, selling assets, issuing additional shares of stock, etc.

Secured Claim: A lien on or a right of set-off against property of the estate.

Secured Debt: A debt for which the creditor has collateral in the form of a mortgage, lien, or security interest in certain items of property.

Security Interest: a) the lien created by a security agreement; b) an interest in personal property or fixtures which secures payment or performance of an obligation.

Set-off: The Bankruptcy Code provides for the right of a creditor to offset a mutual debt owing to the debtor against the creditor's pre-petition claim if the creditor's debt arose before the filing of the case. Certain rules and exceptions may apply.

Office of the U.S. Trustee: A federal officer supervised by the court, who oversees the administration of bankruptcy cases.

Unsecured Claims: a) Claims for which the creditor has not obtained a lien; b) amount by which the value of the property subject to the lien is less than the amount of the creditor's claim.