

What You Need to Know About Chapter 11

Your company is considering filing for Chapter 11 bankruptcy and you think you're well-prepared. But are you? You're confident that you know your company inside and out. After all, you file your 10-Q and 10-K reports, so what information could possibly be new? The first step you should take before filing is to get a full grasp of the situation in front of you and what lies ahead. Title 11, Chapter 11: Read it and look at the forms that need to be filed. Then read it again, especially section 521 — debtor's duties. If you are going to petition the US Bankruptcy Court for relief, you need to learn how to look at your company in a new way — as the court, the US trustee and your creditors will look at it. The company will become a debtor-in-possession subject to the orders of the court. Know ahead of time what will be required of you so that you are prepared to provide and distribute information as required, take actions in a timely manner and follow the procedures that will lead your company to become viable and profitable again.

By Catherine Buhaly Ibold and Kate Logan

Assemble Your Team and Plan

Once you begin to grasp what you are in for, accepting that every company is subject to unforeseen circumstances, it is time to make the small “p” plan. Designing and putting strategies into place ahead of time makes for a smoother transition through each step of the process. You don’t build a house without first drafting a blueprint, estimating costs and calculating timeframes. Use the resources at your disposal: your AP system, your IT department website and your pre-existing network of employees who know your company from the inside. You’ll need to assemble a team who will be able to work with your outside partners, your bankruptcy counsel and case administrator efficiently and productively to ensure a smooth procedure.

Knowing that bankruptcy is an option your company is considering, what steps must you take to prepare prior to filing? First, there is the selection of the company’s professionals, including outside bankruptcy counsel, reorganization or turnaround specialists, and administrative agents. These are the individuals who will guide your company through the rough waters ahead, so it is imperative that you take this selection process seriously. You are interviewing the people who you will rely on for guidance over the next few years; knowledge, expertise and professionalism are as important as a “good fit” with your company and corporate culture. These professionals have been through this many times before so you’re fortunate to have a lot of experience available to you. Use it to your advantage, but learn as much as you can about what each one is bringing to the table. And make sure that all the bases are covered. The last thing you need during either the pre- or post-petition process is to have to put out a fire that you thought someone else was addressing.

In addition to the selection of outside professionals, one of your initial steps is to form an internal cross-functional team. It must include key management such as the general counsel, CFO and controller, risk manager, upper level accounts payable staff, real estate counsel or upper level lease administrator, and contracts attorney or upper level contracts administrator. Determining who to include is essential. These people may eventually oversee a team of their own, covering their specific areas of expertise. Those heading the different teams must have knowledge of their



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areas, but be trustworthy enough not to disclose any information too soon. As the company forms its internal team, one person should be appointed to control the overall process.

Your Point Person Is Crucial During Transition

Having a point person from the beginning will enable an even transition to the subsequent stages of the bankruptcy process. Future responsibilities could include supervising the preparation of the statement of financial affairs (SOFA) and the Schedule of Assets and Liabilities (the schedules), supporting and supervising the claims management and reconciliation process, providing information to outside counsel to support claims objections, working as the company’s main liaison with case professionals to resolve claims, coordinating the cross-functional teams and meeting deadlines and relaying information to the company’s upper-level management. This person will need to review the monthly reporting requirements and US trustee deadlines to be sure the company is not surprised when information is requested. This person also needs to create a “working group list” of all professionals with their roles and information so team leaders know who to contact in order to avoid any duplication of effort.

Your Team Is in Place, Now What?

You’ve hired your professionals and you’ve assembled your internal teams. Now what? A Chapter 11 case brings with it certain important protections that arise immediately upon the initial filing of the petition — most notably the protection of section 362 and the automatic stay that limits creditors from continued collection efforts outside of the bankruptcy court. Although the company will benefit from the moratorium on debt collection, there is a flurry of other activity that accompanies the filing within the first days of the case. Debtor’s counsel typically seeks a number of orders that will allow the debtor to continue to do business, retain bank accounts, reject certain contracts, provide assurance of payment to utilities and hire professionals to assist with the case. The contents of these “first-day motions” vary depending on the needs of the debtor.

The drafting of the first-day motions is typically preceded by a period of due diligence by debtor’s counsel and advisors. Knowing that the company cannot advertise

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its plight, how do you prepare the information necessary for the drafting of your first-day motions? At this early pre-bankruptcy filing stage, a great deal of discretion must be exercised as only a limited number of employees and executives can be aware that a bankruptcy filing may be imminent. If word of an impending or even potential bankruptcy circulates, it can have negative implications on many business levels. For instance, vendors may cease shipping or require cash on delivery instead of extended payment terms; creditors may seek to exercise remedies or foreclose on debts; customers may be afraid to purchase and employees may start to look for other positions — during a time when you need their assistance with information gathering and historical knowledge. Moreover, the pre-filing due diligence may generate other options that make a Chapter 11 filing unnecessary, but if word gets out, those other options may evaporate.

Compile Your Creditor Matrix

Among the first-day motions and papers filed is a compiled creditor matrix. Collecting and gathering the information needed is crucial to a well-run process. The creditor matrix — a list of all your creditors and potential creditors — must comply with code and rule requirements, which can vary from district to district. You will need to communicate with your internal team clearly and efficiently, sometimes without disclosing the potential filing on the immediate horizon — no easy task, but not insurmountable. The creditor matrix is also the foundation for the compilation of the schedules. Preparation of the schedules and the efficient, fair administration of the bankruptcy case are inextricably tied together. The quality and accuracy of the initial schedules (a list of all your creditors including, among other things, amounts owed) will dictate the debtor's costs in terms of time and fees. Unfortunately, a debtor's accounting and contracts systems are not usually prepared for the burdens and accuracy required of a bankruptcy filing; therefore, these schedules should be reviewed for weaknesses and inaccuracies to prevent shortcomings from adding to the reporting burden after the filing is made.

Most first-day hearings occur within two business days of a case commencement. Effective dissemination of the notice of the hearing is crucial as parties need to know if their rights will be affected. When compiling the list of the top unsecured creditors for the bankruptcy petition, the address, contact, telephone and fax number information must be current and accurate. These major players, some of whom will be members of the creditors' committee, need to be served efficiently and kept in the loop every step of the way. More importantly, when the time comes for the US trustee to appoint the creditors' committee, this information will be ready and in place. Additionally, the US trustee will also want to see the company's insurance policies.

While assembling the creditor matrix, many holes in company data may be revealed. What might be considered accurate address information for the delivery of a check or invoice, however, may not be appropriate for the delivery of a bankruptcy notice. Be sure you have current and accurate contact information for all bank accounts so that notices are not delivered to a lockbox instead of on the desk of the branch manager, who will keep your accounts open and active. The same rationale applies to utility notices that will keep the lights on and the computers running.

It is easy to say every company should have a contracts management system that tracks all of its executory contracts and unexpired leases, a database of real and personal property and a lease abstract system that keeps track of leases and subleases. However, that is not always the case. Having a barrage of outside counsel and consultants invading your headquarters and tearing through your files is unpleasant for employees, raises more than a few suspicious eyebrows and can be quite expensive. It is therefore better — if you have the time and the staff — to put those systems in place in the months before filing, even if this is a “contingency” action. It is one of those “necessary but not urgent” management tools that are easily put on the back burner, but will serve the company well in the long run. During the final days before a filing, it will become both necessary and urgent and you'll be glad you were prepared. In addition to insuring a proper listing in the schedules, it will serve you well when decisions are made about assuming and rejecting leases.

Create a litigation database and make sure that it is maintained and current. People move, legal representation shifts, a case may change venue. Make sure these facts are updated and that the noticing agent is kept abreast so that each and every potential creditor receives proper notice. The last thing any debtor wants months or years after the bankruptcy is to uncover a creditor or group of creditors who was not properly noticed, and who may therefore not be subject to the court's orders.

The company must also be sure its corporate books are

up-to-date with the correct and current list of officers and directors, especially if there are multiple debtors with differing responsible parties. Management should determine who will be available to sign the petitions on behalf of the company prior to the filing date.

Do Not Avoid Communicating with Stakeholders

One often-neglected task facing management is the need to communicate the company's circumstances and plans to the various stakeholders, both internal and external. Develop a communication program with vendors, customers, employees, landlords and other key parties. As each and every vendor, customer, employee and landlord is a potential creditor, this communication stream should be initiated immediately upon filing. For instance, make sure you have all email addresses, phone and fax numbers readily available for immediate communication. Faxing or emailing a notice is more efficient and less costly than either standard mail or overnight delivery. As the largest vendors may end up on the US trustee-appointed creditors committee and thereby will hold major sway in the development and acceptance of your plan of reorganization, impeccable communication with them is imperative. Phone calls should be made to key vendors by select officers of

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the company. Work with your case administrator to collect, process and manage the data so that the most accurate, efficient, non-duplicative information is at your fingertips.

You can also use the internet to communicate with the larger pool of creditors. Develop a reorganization link on your company's website including, if appropriate, a link to the claims agent's website. Creating a brief FAQ page can save your corporate office phones from ringing off the hook from the first day of commencement through each step in the process. Have your bankruptcy counsel vet a press release to issue on the filing date, then again at each appropriate stage, perhaps even for publication in industry journals and newspapers. Using in-house IT people who are already on the payroll can be a great way to save on the expense of updating your progress. Think of innovative ways to communicate with anyone with whom you would

like to continue doing business. Let the world know that you are available and ready for profitable collaboration.

Set up a dial-in number for customers and vendors. It should have a set script for each type of call, with the message pre-screened by bankruptcy counsel. A small mom-and-pop-shop vendor, an unhappy customer you would like to hold on to or a retired employee may not understand that a reorganizing debtor continues business-as-usual after the filing. A well-written script can help your creditors (and your employees) understand how they may or may not be affected. Answering a confused customer's question may prevent her from filing an unnecessary claim and will eventually save you time and money. Docketing, balloting

and objecting to a claim filed by someone who isn't owed any money adds to your expenses, thereby reducing the overall potential recovery of legitimate claim holders.

Be ready to communicate with your staff, both past and present, by developing an employee communication program. Access to current employees email addresses may be a no-brainer, but if there are subsidiary and ancillary businesses on different systems make sure you have the ability to communicate to all, or to specific groupings, at a moment's notice. Set up dial-in conference calls if necessary, conduct calls with supervisors or use a town hall format. Explore the potential for updating an employee-accessed website to inform them about their rights, to

ACC Extras on...Your Company's Finances

ACC Docket

- *The Contractual Cogitator: A Lesson Learned on Contractual Lists (June 2009)*. In the column, Bob Feldman reviews the case *In re Delta Mills, Inc., Bankruptcy No. 06-11144 (CSS), Adversary No. 07-51707 (CSS), 2009 WL 723271* (Bkrcty.D.Del., March 17, 2009), a suit between GMAC and a textile manufacturer in Chapter 11. www.acc.com/docket/cog_contractual_jun09
- *Small Law: Financial Controls for Small Law Departments (Jan. 2007)*. For closely held companies, which are not mandated to comply with section 404 of Sarbanes-Oxley, a lack of internal controls can create an atmosphere for improper financial oversight. Corporate counsel must help make sure that financial controls are in place to adequately protect the company. www.acc.com/docket/smlaw_fincontrols_jan07
- *Audit Committees Under the Sarbanes-Oxley Act: Establishing the New Complaint Procedures (July 2003)*. Written in the wake of the Enron situation, this article examines the Sarbanes-Oxley Act as a means of reiterating the importance of honest accounting to avert potential compliance crises. www.acc.com/docket/auditcomm_soa_jul03
- *Developing a Crisis Management Plan (Sept. 2000)*. The watchwords for avoiding corporate crises and better managing the unavoidable are "planning" and "preparation." This article addresses the components of a workable and adaptable crisis management plan with an emphasis on the role of in-house counsel in planning for, and responding to, a catastrophe. www.acc.com/docket/crisis_mgtplan_sept00

Quick References

- *Top Ten Key Questions (and Answers) for Dealing with Financially Distressed Suppliers (June 2008)*. www.acc.com/quickref/top10_findistsup_jun08
- *Chapter 11 (Jan. 2007)*. Provides an overview of the impact of bankruptcy on a company's overseas operations. Includes

European regulations, an intro to French bankruptcy, the impact of Chapter 11 overseas and a model communication package for overseas operations. www.acc.com/quickref/chap11_jan07

Sample Form & Policy

- *Letter of Intent that is Binding in Part (Nov. 2006)*. This letter of intent (letter) sets forth the basic terms and conditions upon which a Maryland corporation and limited partnership (purchaser) intend to acquire a licensed bed nursing home facility — owned and operated by the corporation as debtor-in-possession under a Chapter 11 bankruptcy case pending in the US Bankruptcy Court. www.acc.com/forms/letterofintent_nov06

Program Materials

- *Bankruptcy Basics (Jan. 2002)*. Originally presented at ACC's Northeast Ohio Chapter in January 2002, this material includes sample forms and articles like "Chapter 11 Reorganization" and "Acquiring Financially Troubled Businesses." www.acc.com/bankruptcybasics_02
- *Litigation Aspects of Bankruptcy: Protecting Your Client's Assets and Preserving Their Rights (Oct. 2003)*. Find out how to protect your company's precious assets while preserving its rights. www.acc.com/lit_bankruptcy_oct03

Webcast

- *Software Licenses in Bankruptcy Proceedings (June 2006)*. This transcript includes a discussion of why keeping software licenses is important to a company's operations during the bankruptcy proceedings of the software licensor. www.acc.com/webcasts/swl_bankrupt_jun06

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maintain morale and to request their cooperation. Most employees are very invested in the future success of the company for which they work, so make them feel a part of the process, not a victim of it.

Another pre-filing detail management need to focus on is the accounts payable system(s). Prior to filing, department heads need to be told to process any invoices on their desks. The AP staff must be given enough time to cease mailing checks prior to the actual date of filing to avoid the issues and fees associated with returned checks. They should also be made aware of the possibility of having to reclaim funds considered preference payments. The first day of filing — a new company — the debtor-in-possession, will be running the show. The accounts payable and IT departments need to be prepared to handle this change and to understand the difference between pre- and post-petition. AP staff should be given written instructions for splitting invoices between pre-bankruptcy and post-bankruptcy dates.

Never Underestimate Debt and Contingent Obligations

Management often underestimates the universe of the company's debt and contingent obligations while it focuses on the restructuring process and the current operating and financial crisis. While the cross-functional team, bankruptcy

professionals and bankruptcy counsel are focused on the case, preparing the schedules and “first-day motions,” the management team has the job of continuing the business of the debtor-in-possession. The process of filing the schedules can expose the full scope of the debt, so be prepared for a new perspective on the company you thought you knew so well.

These are a few suggestions to make the initial Chapter 11 bankruptcy process run more smoothly. With preparation, early planning and teamwork, the costs of a bankruptcy case can be reduced and the chances of a successful reorganization improved. The more groundwork you do ahead of the petition date, the better positioned you will be to notify creditors, alert utility companies and banks and mitigate damages to your vendor relations. Debtor's counsel and the administrative agent are excellent resources — use them. That said, while they may know the bankruptcy process, you know your company better. Even in the best of circumstances, a Chapter 11 filing will be an onerous and anxiety-producing process for all involved. But by thinking and acting ahead of time, the company can improve its odds of successfully reorganizing into a streamlined, viable business model. 

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