

CREDITOR'S RIGHTS TOOLKIT

What Is the Life Cycle of a Chapter 11 Bankruptcy Case and Why Do Stakeholders Need to Pay Attention to the Bankruptcy Case? (Part I)

A Chapter 11 bankruptcy is often called “reorganization bankruptcy” and is typically used to preserve and maximize the going concern value of the debtor’s business. The life cycle of a Chapter 11 bankruptcy case can be conceptualized in five stages. It is important for creditors, contract parties, and other parties-in-interest to understand these stages and how their rights and financial interests can be affected during the bankruptcy case. Part I of this series reviews the beginning and middle stages of the bankruptcy proceeding.

Key Issues

STAGE 1: PREPETITION PLANNING

• PREPARING FOR FILING BANKRUPTCY

The first stage is the period of preparation by the debtor and its professionals. Generally speaking, there are three approaches: a free fall, a prearranged case, and a prepackaged case. In a free fall case, the filing is an emergency and the company simply does not have time to negotiate the terms of its restructuring and bankruptcy exit strategy with its key creditors. As a result, in a free fall case, often there is no agreement regarding the use of cash collateral or a debtor-in-possession (DIP) loan to fund the case. A free fall case is the opposite of a “prepack” or a “prearranged” case. Prepacks are rare and involve the solicitation of votes on a plan before the bankruptcy is even filed. A prearranged bankruptcy simply means that the debtor has engaged in discussions with major creditors before the filing and has some agreement in place regarding how the case should proceed. It is common in a prearranged bankruptcy that certain creditors will execute a “Restructuring Support Agreement” in advance of the filing.

STAGE 2: FILING PETITION AND “FIRST DAYS” OF A CHAPTER 11 CASE

- **FILING OF PETITION**

A Chapter 11 case is commenced upon paying the requisite filing fee and filing a petition for relief with the clerk of a bankruptcy court. Upon the filing of the petition, existing management typically continues operations during the Chapter 11 proceeding and remains in control of the business as the DIP. In more complex cases, a chief restructuring officer may be brought in to assist or replace the debtor’s most senior management.

- **“FIRST-DAY” MOTIONS**

Either simultaneously with the Chapter 11 petition or in the early days of Chapter 11 proceedings, the debtor will file emergency motions (referred to as “first-days”) designed to minimize any disruptions to the company’s operations and to continue beneficial operations in bankruptcy. First-day orders become binding on creditors and other parties in interest. Some first day orders will be interim in nature, and will become finalized after a later hearing. Creditors that have significant claims against the Chapter 11 debtor, or have material ongoing relationships with the debtor, need to understand the terms of the first-day motions and the relief sought by the debtor so they can ensure that their rights are not adversely affected.

STAGE 3: THE MIDDLE STAGE OF A CHAPTER 11 CASE

- **CREDITORS COMMITTEE AND MEETING OF CREDITORS**

Approximately two weeks after the petition is filed, the U.S. Trustee (UST) will appoint an official unsecured creditors’ committee to represent the interests of all unsecured creditors in the case. Early in this middle stage, the UST will also hold a “first meeting of creditors” (also referred to as a “341 meeting” because of the Bankruptcy Code section that requires the meeting to occur). At the 341 meeting, the UST will ask the debtor about its income, outstanding debts, property, and other issues related to the case. Creditors may, but are not required to, attend and pose additional questions to the debtor.

- **PROOF OF CLAIM BAR DATE**

The court will set a deadline for creditors to file proofs of claim (referred to as the “bar date”). In a Chapter 11 case, the bar date may depend on local practice or court order, and the amount of time provided to file a proof of claim can vary. Creditors must be vigilant of the bar date and file a proof of claim for any amounts owed by the debtor in a timely matter. A creditor’s failure to timely file its proof of claim may result in disallowance of the claim, meaning it will not receive any distribution from the bankruptcy.

- **EXECUTORY CONTRACTS AND UNEXPIRED LEASES**

During the middle stage, the debtor may determine that disposing of certain contracts, licenses, leases, or a sale of assets or its entire operations, is necessary to reorganize its business. The debtor has the authority to assume, assign, or reject executory contracts and unexpired leases. The debtor’s rejection of a contract or lease constitutes a breach of contract by the debtor that is deemed to have occurred immediately before the

petition date, and the contracting party holds a general unsecured claim for damages arising from the rejection. If the debtor assumes the executory contract the debtor has to pay (“cure”) in full any payment or other defaults and show that it can actually perform under the contract or lease going forward. If the debtor wants to assume and assign the executory contract to a third party, commonly a buyer of its assets, at a minimum, the debtor (or the purchaser) has to cure any defaults, and the buyer has to reasonably assure the counterparty that it will perform on the contract in the future. The debtor’s decision to assume, assume and assign, or reject a lease or contract requires court approval, though the Bankruptcy Code contains certain deadlines for real estate leases. Creditors should pay careful attention to a debtor’s filings relating to these issues and timely object if, for example, they disagree with the proposed cure amount.

- **363 BANKRUPTCY SALES**

In some instances, a Chapter 11 case will be filed for the purpose of making the debtor’s assets more attractive to buyers, because they can be sold “free and clear” of claims and interests under § 363 of the Bankruptcy Code (referred to as a “363 sale”). Often a going concern asset sale will constitute the effective “middle” of a bankruptcy case because, once a sale of substantially all assets is consummated, the debtor can formulate its exit from bankruptcy under a plan of liquidation or structured dismissal.

Takeaway

Understanding the intricacies of Chapter 11 bankruptcy is crucial for creditors, contract parties, and other parties-in-interest, as their rights and financial interests can be significantly impacted throughout the process. The initial stages of a Chapter 11 case, including prepetition planning and the filing of first-day motions, set the foundation for how the bankruptcy will proceed and can influence the debtor’s ability to reorganize effectively. During the middle stage, active participation and vigilance are essential, particularly regarding the proof of claim bar date, the handling of executory contracts and unexpired leases, and any potential 363 sale. By staying informed and engaged, parties-in-interest can better protect their claims and interests, ensuring they are not adversely affected by the debtor’s restructuring efforts.