CHAPTER 2
THE LIFE CYCLE OF A CHAPTER 11 DEBTOR THROUGH THE DEBTOR'S EYES

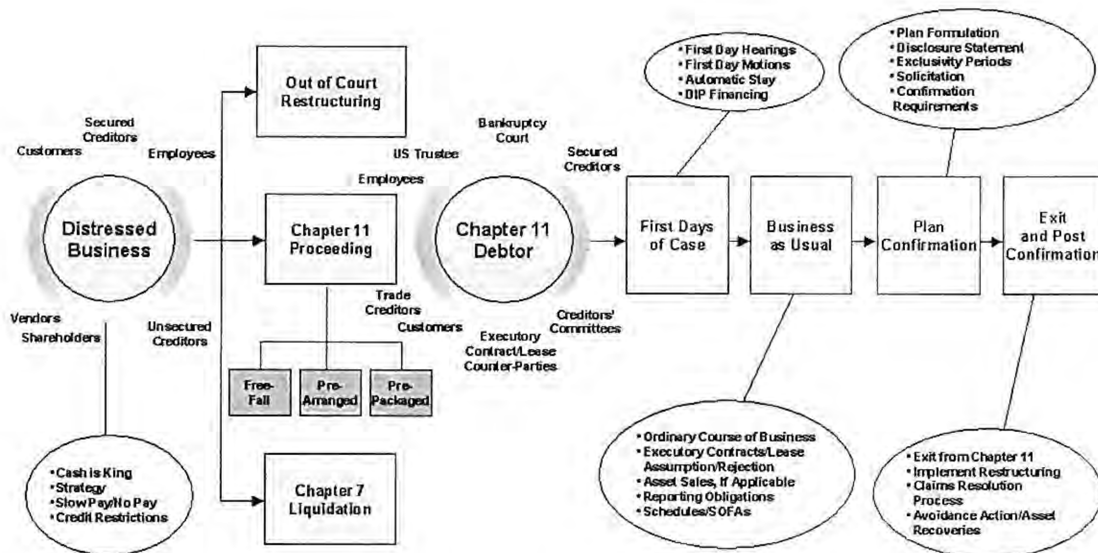
We continue in this chapter our broad brush overview of the buffet. We'll get back in line and sample each dish in subsequent chapters.

The chapter 11 process may be conceptualized as consisting of a number of distinct but overlapping stages. The paradigm is imperfect, and the order in which the stages come can be different, but thinking about a hypothetical chapter 11 case in this way is a useful device.

Think of a case as having four stages:

- The first stage is the period of preparation by the debtor and its professionals for the chapter 11 filing. This is sometimes referred to as "contingency planning" because options other than a chapter 11 filing are pursued while the bankruptcy preparation ensues and potential debtors often end up not filing for bankruptcy due to the implementation of one of these other options.
- The second stage consists of the first days and weeks of the bankruptcy case. These days are full of activity and occupy a great deal of management's time and a great number of lawyer hours.
- The third stage is the "middle" of the chapter 11 case. This can be a relatively slower period of activity, in which a debtor's management typically can focus on business operations again. But because of the restrictions placed on a debtor by the bankruptcy laws, chapter 11 is never completely "business as usual." A debtor must still consult with counsel on a myriad of issues, and will spend a lot of time negotiating, perhaps litigating, with interested parties.
- The fourth stage is the rest of the case. Most of the activity in this stage relates to the exit from chapter 11, usually either by a reorganization plan or by sale of assets.

Here is a pictorial representation:



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Preparation Stage

A chapter 11 case brings with it certain important protections that arise immediately upon the filing of the petition, most notably the automatic stay of §362. However, with these statutory protections come restrictions that limit a debtor's unfettered discretion to operate without court approval.

Debtor's counsel typically seeks a number of orders in the first days of the case in an effort to minimize the disruption caused by chapter 11. Certain of these "first-day orders," as they are called, are designed to override statutory prohibitions of the Bankruptcy Code. For example, the Code generally prohibits a debtor from paying any pre-petition debts, so a debtor may file a motion seeking permission to pay pre-petition employee wages or pre-petition claims of critical trade vendors.

Other first-day orders are sought to take advantage of powers uniquely given to a debtor in bankruptcy. For example, a motion to reject executory contracts may be filed as a first-day motion.

Yet other first-day orders must be procured either out of administrative necessity or to seek modification of specific Bankruptcy Code requirements. Examples include applications to retain professionals, motions to jointly administer related cases, and motions to maintain current bank accounts and cash-management procedures.

Finally, debtors will often file first-day motions to assure the availability of cash, including a motion for authority to use a secured creditor's "cash collateral" and a motion for approval of post-petition financing. The relief that debtors request on the first day varies depending on the debtor's needs and the willingness of the court to grant the kinds of relief the debtor would like to have.

The drafting of first-day motions is typically preceded by a period of due diligence by debtor's counsel. Counsel must establish contact with the appropriate employees of the debtor, and measures must be implemented to ensure confidentiality of the bankruptcy-related discussions.

At this early stage in the bankruptcy preparation process, a great deal of discretion must be exercised because often only a limited group of the debtor's employees are aware that a bankruptcy filing may be imminent. If word of an impending bankruptcy filing leaks out, it can lead to serious adverse consequences—vendors may cease shipping, other creditors may seek to exercise remedies, competitors may seek to take away business, customers may look elsewhere, and employees may hit the street looking for a more secure job. As a result, the employees who are best equipped to provide the lawyers with the information they need are sometimes unavailable. More generally, a debtor may be operating with a significantly reduced workforce, further limiting the debtor's resources available to assist in preparing for bankruptcy.

The First Days of a Case

A chapter 11 case may be commenced on a voluntary or involuntary basis. A company (or individual, but for ease, we say "company" throughout) commences a voluntary chapter 11 case by paying the requisite filing fee and filing a petition for relief with the clerk of a bankruptcy court. A company may file its bankruptcy case in the jurisdiction in which it is incorporated, where it has maintained a residence, principal place of business, or principal assets for at least 180 days, or where the bankruptcy case of an affiliate is already pending. Upon the filing of a voluntary petition, the company becomes a "debtor," and its board of directors and management will continue in place as the DIP until the debtor's plan of reorganization is confirmed, the debtor's case is dismissed or converted to a chapter 7, or a chapter 11 trustee is appointed.

The first-day motions are typically filed at the same time the bankruptcy petition is filed. Sometimes these motions are actually heard on the first day, but more often within the first couple of days. Many first-day motions are true emergencies, but some are not. It is good practice to call something an "emergency" only if it really is one; the "first-day hearing" is counsel's first chance to gain—or lose—credibility with the judge, and that credibility is your—and perhaps your client's—greatest asset.

The first days of a case can be quite time-consuming for a debtor's management. To begin with, representatives of the debtor must be present at the hearings on the first-day motions. Moreover, inquiries from customers, suppliers, creditors, investors, employees and sometimes the media abound. At the same time, the debtor must meet with the UST, comply with a host of

administrative requirements and work on the preparation of a set of bankruptcy schedules that, in even a small case, can be a substantial undertaking.

Shortly after the bankruptcy filing, the UST will usually appoint a creditors' committee and sometimes other committees to represent the interests of creditors and/or other stakeholders. These committees may consult with the debtor on the administration of the case, investigate the conduct of the debtor and the operation of the business, and participate in the formation of a reorganization plan. In addition, a creditors' committee may, with the court's approval, hire an attorney and/or other professionals to assist in the performance of the committee's duties.

Protracted negotiations with the committees are typical. The early days of the case provide the debtor with an opportunity to educate the committee and its counsel, and to develop a working relationship with the committees. This can be a key to success in chapter 11.

Early negotiations with other major creditors is also typical—particularly with major pre-petition secured lenders. If the debtor requires post-petition financing, it will also spend a lot of time early in the case (and indeed, pre-petition) with its post-petition lenders, which may be the same entities that loaned it money pre-petition, or perhaps be new lenders.

Immediately upon filing, the debtor and everyone that deals with the debtor become subject to the rules of the Bankruptcy Code, which include the following.

The Automatic Stay

The commencement of a bankruptcy case triggers an "automatic stay," which, with certain exceptions, operates as an injunction against actions affecting the debtor or its property. The automatic stay provides a respite for the debtor and also protects the creditors as a group by bringing to a halt actions by individual creditors to obtain satisfaction of their claims using remedies generally available under state law.

The automatic stay usually does not protect parties who are not themselves in bankruptcy, such as guarantors or co-obligors. (There are limited exceptions to this in §§1201 and 1301, but they apply only in chapters 12 and 13). On occasion, a judge will be willing to extend the automatic stay to a non-debtor in a chapter 11 case, but those instances are not common.

Moreover, the Bankruptcy Code also expressly carves out a number of exceptions to the scope of the automatic stay, which are listed in §362(b). A creditor may seek relief from the automatic stay. The standards for obtaining relief are set forth in §362(d).

Use, Sale or Lease of Property of the Estate

The debtor may use, sell or lease its property in the ordinary course of its business without authorization from the bankruptcy court. However, the use, sale or disposition of any property outside the ordinary course of business requires court approval. The ordinary course of business has two dimensions—ordinary for the debtor and ordinary for businesses like the debtor. For example, a retail debtor can sell its inventory to retail customers without court

approval, but if it wants to sell whole stores or enter into major new leases, it will require court approval. There are closer calls, of course, and sometimes a debtor will seek court permission "just to be safe." Bankruptcy Code §363 and interpretive cases govern this inquiry.

New Credit

Some debtors have enough unencumbered cash to enable them to operate in chapter 11 without new cash infusions. Even these, however, must usually rely on cash that is subject to a lender's security interest, referred to as "cash collateral." In order to use cash collateral, a debtor must obtain agreement of the secured party or court authorization. If the creditor does not consent to the use of its cash collateral, then the debtor must provide "adequate protection" to the lender—essentially, the debtor must compensate the creditor in some way for the use of its cash collateral or show that the collateral's value will not diminish to an unacceptably low level through the proposed use. All of this is laid out in a relatively straightforward manner in §363, and is discussed in more detail in chapter 16 of this book.

However, many debtors cannot survive even with use of cash collateral. Instead, a debtor may require a line of credit or other post-petition financing. Bankruptcy Code §364 permits a debtor to borrow funds and offers protections and priorities to induce lenders to make these loans, which are referred to as debtor-in-possession loans or simply "DIP loans."

These inducements are offered to lenders because, without them, lenders might be unwilling to loan money to a bankrupt company, or at least the cost of borrowing would be much higher. The inducements consist of a steadily increasing series of liens and priorities:

- The first is ordinary administrative priority.
- Second is priority over other administrative expenses (so-called "super-priority").
- Third is a lien on unencumbered assets.
- And finally, if the debtor cannot get financing on any other terms, the court may authorize a lien that is equal to, or even senior to, other liens on estate assets. While intuitively it may seem a risky proposition to lend to a company in bankruptcy, because of the incentives and protections provided by the Bankruptcy Code to DIP lenders, it is often a very safe proposition for DIP lenders, provided that they properly take advantage of the protections offered in §364. And it can be a profitable business, since these loans often come with hefty fees.

Executory Contracts and Leases

The Bankruptcy Code contains no precise definition of an "executory contract." As a general matter, an executory contract is one in which performance remains due to some extent on both sides (for instance, ongoing leases or supply agreements). Bankruptcy Code §365 provides the debtor with tremendous flexibility regarding these types of ongoing agreements. They can be assumed and performed by the debtor, assigned to a third party (in most cases) or rejected. By

assuming (or assigning) a contract, the debtor binds itself (or its assignee) and all other contracting parties to perform the contract fully in accordance with its original terms. Rejection of a contract constitutes a breach of the contract and entitles the non-debtor party to a claim against the estate.

Although the debtor can generally assume or reject any contract, it can not unilaterally modify one. Rather, if it wants to modify it must negotiate with the other party for desired changes against the back drop of the alternatives of eventual assumption or rejection. The decision to assume, assume and assign, or reject a contract requires court approval, but courts typically defer to the debtor's business judgment. Until a contract is assumed or rejected, both the debtor and the non-debtor party are generally obligated to perform under it.

As a general rule, a debtor is not obligated to make the decision to assume, assign or reject until the confirmation of a plan. A party bound under a contract or lease with a debtor may, however, successfully move for an earlier deadline, if it can show that the delayed decision would prejudice it in some significant way. There is an exception for commercial real estate cases: there, the debtor gets no more than 210 days.

For public policy reasons (or as a result of special interest pressure), the Bankruptcy Code contains provisions that deal with certain types of executory contracts, including leases of commercial real estate, shopping center leases, aircraft leases and financing agreements, timeshare contracts, commitments to maintain the capital of a federally insured bank and intellectual property licenses. Although each special provision is different, the general effect of each set of rules is to restrict the debtor's rights and increase the protections afforded to the non-debtor party to the contract.

The "Middle" of the Case

Activity in a chapter 11 case often slows down a bit after the first few weeks. Business operations tend to normalize, and the debtor is in many ways able to conduct "business as usual." However, in addition to running its business, the debtor must comply with the various obligations bankruptcy law imposes, and must remain cognizant of deadlines imposed by the Bankruptcy Code and Rules. There will be disclosure obligations, less confidentiality, and more public scrutiny than before bankruptcy. Various constituencies will feel free to comment on what the debtor should or should not be doing and to attempt to second-guess decisions that outside of bankruptcy would be within the sole purview of management. And the debtor will have to obtain court approval for some acts that it previously could undertake in its discretion. So, "business as usual" is relative.

Early in the "middle" of the case, the debtor must attend a "first meeting of creditors" (also referred to as a "341 meeting" because of the Code section that requires the meeting to occur). At this meeting, the debtor (through a representative, if it is an entity) must answer questions posed by the UST, and sometimes by creditors, under oath. Other "administrative" obligations of the debtor in the middle of the case include the filing of monthly operating reports and the payment of quarterly fees to the UST. Of course, the debtor must ordinarily comply with its nonbankruptcy obligations as well, such as filing tax returns and SEC filings.

The "middle" of the case also affords the debtor a chance to evaluate its business and legal strategies. The specifics will, of course, vary from case to case, but business strategy evaluation might include things like whether to sell or shut down stores or plants or particular business lines, whether the workforce is of optimal size, ways to reduce expenses and improve profitability, and so forth. Legal strategy will include ways to use the special powers of a debtor to enhance the estate, including assumption and rejection of contracts and actions to avoid and recover pre-petition payments.

Finally, the middle of the case will involve a lot of negotiating with players in the case, including committees, the UST, secured creditors, landlords, labor unions, government agencies, suppliers and others. Some of this negotiation will relate to exit from bankruptcy, but much of it will relate to the various interim issues that arise in every case.

Often interspersed with this negotiation is litigation over various matters, such as creditors who seek relief from the automatic stay, landlords who want the debtor to assume or reject leases, disputes over the extension of various time periods, arguments over whether creditors are receiving adequate protection, and many other issues that can arise.

Through all this, the debtor—with counsel's assistance—must focus on the ultimate objective of the case and try not to get too distracted by the myriad issues that arise. This stage of life is, for some debtors, the beginning of the golden years, while for others it is a mid-life crisis.

The Rest of the Case

Any entity that subjects itself to chapter 11 obviously has some serious problems that need to be fixed. Broadly stated, there are two ways chapter 11 helps a debtor deal with its problems. First, it provides the debtor with a host of powers that can help it to remedy operational problems. The ability to reject executory contracts and unexpired leases is one well-known example. Second, chapter 11 enables a debtor to restructure its balance sheet to better reflect the actual—and usually diminished—ability of the business to service debt. This is accomplished through the formulation and approval—the "confirmation"—of a chapter 11 reorganization plan.

Insofar as chapter 11 often is just a matter of making a deal with various stakeholders, one may well ask, "why can't you just do it all informally, without the cost, inconvenience and stigma of a bankruptcy case?" The answer is you can, and often you do when you don't need to use unique "bankruptcy powers" to make an operational fix. Plenty of times a debtor and its creditors can simply make and carry out deals without court intervention, so much so that some people even refer to an out-of-court workout as a "private chapter 11."

But chapter 11 does permit you to accomplish some purposes that you may not be able to achieve on your own. Here are a few:

- Perhaps most important, if you get the right number of votes, you can impose the plan on dissenters (while outside of chapter 11 you may not even be able to find all of the creditors, much less get their attention or their consent).

- Because of the automatic stay, you get to hold creditors at bay while you try to make your deal.

- You get a "cleaner deal" than you may be able to get outside bankruptcy—more clarity and finality about the rights of the parties all wrapped up in a confirmation order that is enforced by a federal judge, is not subject to collateral attack, and is binding on all state and federal courts once it is final and non-appealable—generally 10 days after entry.

- You get to use some of those bankruptcy powers that simply aren't available anywhere else.

The confirmation of a plan may be viewed as the last step in the fix, or alternatively as a description of what the fix is and how it will be implemented. A confirmed plan becomes the "law of the case"—a substitute contract that replaces the old creditor claims and equity interests.

Some debtors, as we discussed in a prior column, do not use chapter 11 to reorganize, but as a forum for an orderly liquidation. But even in those cases, the plan is the "fix" that dictates the parties' rights—who will sell the assets, how they will be sold, over what time period and who will receive the proceeds. It is worthwhile to note that, with increasing frequency, the "fix" that is seized upon by debtors is a sale of all or substantially all estate assets under Bankruptcy Code §363 rather than a reorganization plan—a phenomenon that may make some bankruptcy judges feel like auctioneers—but the prototype is still a chapter 11 plan, and so we discuss that here and leave §363 sales for discussion in chapter 16.

It is impossible to generalize what activities and events will occur in any particular chapter 11 case because each case is so different. However, the typical chapter 11 case does involve certain interrelated groups of activities or processes. These include claims administration, avoidance and confirmation. We offer some thoughts on each below.

There is no rule that prescribes the order in which such tasks must be completed. Rather, when, or even if, these activities will take place in any given case will depend on a multitude of factors, including whether the case involves a "free fall," "pre-arranged" or "pre-packaged bankruptcy;" whether the case involves a reorganization, liquidation or a sale of all assets to a third party; and the level of creditor cooperation. It will also depend on what issues are of most pressing concern in the particular case.

The manner in which one of these tasks is performed may impact the others. For instance, the claims-administration process is sometimes a critical part of the plan-confirmation process. As we touch upon later, a plan cannot be confirmed unless the bankruptcy court makes a number of specific findings. One such finding is that the debtor will be able to pay most §503 and §507 "administrative" and "priority" claims—those claims that Congress has determined should enjoy priority over other unsecured claims—on the "effective date" of the plan. Thus, thinking ahead to confirmation, debtors sometimes spend great resources on claims administration, addressing not only the validity and amount of claims, but also their priority levels. Successful chapter 11

debtors, however, often (perhaps even typically) defer claims administration and litigation to the post-confirmation period.

Claims Administration

If you are going to pay claims, you have to make sure you know whom to pay. If you are going to solicit votes on a plan, you have to know who gets to vote. If you are going to put claims into different classes, you have to know who goes in which class. So the problem of claims administration requires attention in even the simplest chapter 11 case.

The debtor gets the ball rolling by filing schedules of all its debts. If you are a creditor and the chapter 11 debtor has scheduled your claim correctly, that is enough to put you on the list. If not, you can file a claim (but for what it is worth, your authors would ordinarily file a claim in any event, just to be sure) prior to the applicable deadline (or "bar date").

After there is a complete list of "possible" claims, as a result of the schedules and the proofs of claim, the debtor and other parties have the chance to assert objections. Sometimes these are asserted on a claim-by-claim basis; other times the objections will fall into broad categories and you will see "omnibus objections"—a single pleading objecting, for a similar reason, to dozens or even hundreds of claims. Here are some common objections:

- The claim is invalid under nonbankruptcy law. For the most part, you don't have a claim in bankruptcy unless you would have a claim against the debtor outside bankruptcy, so this objection can be a knockout punch.

- The claim is valid but overstated (the debtor's books and records reflect a lower amount due).

- The creditor is holding money or property of the debtor that he must return before his claim is allowed. (*See* §502(d)).

- The claim was filed too late. Claims filed after the bar date may be disallowed (in chapter 11) or subordinated (in chapter 7).

- The creditor asserts the wrong priority. High-priority claims get paid before low-priority claims. As a general matter, knocking the creditor down the priority ladder reduces his chance of getting paid.

- The claim is an unsecured claim for post-petition interest or professional fees, which are ordinarily not permitted.

Aside from allowing claims for payment, there is the matter of establishing claims for purposes of voting on the plan. To understand this point, you have to know a bit about the voting rules. When read together, §§1126 and 1129 provide that any creditor who is "impaired" by a plan gets a chance to vote on the plan. "Impairment," generally speaking, means that one's rights are changed or affected by the plan. Creditors vote by classes. To confirm a plan, you have to get

the approval of a majority in number and two thirds in amount of claims in each voting class. So, just as for payment, it matters for purposes of voting whether the creditor has an "allowed" claim, how big it is, and what class the claim is in. Claims are sometimes allowed in an estimated amount for voting purposes only, while ultimate resolution of the claim is deferred.

As to classification: Section 1123 provides that the plan may "designate...classes of claims." Section 1122 says you may put a claim in a particular class only if the claim is 'substantially similar' to other claims in the same class. But you may be able to take claims that appear similar for nonbankruptcy law purposes and put them in different classes for purposes of the bankruptcy plan. This happens often enough that some of the worst fights in chapter 11 involve plan classification, with the dissenters arguing that the plan proponent is "gerrymandering" the classes while the proponent argues that there is a principled basis for its classification scheme.

Avoidance

By avoiding a particular transfer of property, the trustee or DIP can cancel a pre-petition (or, occasionally, an unauthorized post-petition) transaction and force the return or "disgorgement" of the payments or property, which then are available to pay all creditors pursuant to the priority rules set forth in the Bankruptcy Code. These powers are used to prevent unfair pre-petition payments to one creditor at the expense of all other creditors. Below are the common avoidance powers in chapter 11.

Fraudulent Transfers: A pre-petition transfer may be avoidable as either "intentional fraud" or "constructive fraud." The former is a transfer made with actual intent to hinder, delay or defraud creditors. Think of the debtor-to-be who is being hounded by creditors, and so conveys his house and his bank account to his mother so that the creditors won't seize them. The latter is a transfer made for less than reasonably equivalent value, while the debtor is insolvent (or which renders the debtor insolvent or leaves it with unreasonably small capital). This category could include, for example, the sale of a $10 million factory for $3 million, or the payment of a dividend to shareholders by an insolvent corporation, even if there was no intent to harm creditors.

The Bankruptcy Code includes its own fraudulent transfer power, set forth in §548 which covers transfers in the two year period prior to the petition date. But a trustee (or DIP) may also use state fraudulent conveyance laws, which tend to be generally similar to the federal statute, but with significantly longer reach-back periods.

Fraudulent transfers are discussed in more detail in Chapter 8.

Strong-arm Powers: Now, take, for example, a different case. Before bankruptcy, the debtor borrowed $1 million from BigBank and, to secure the loan, granted BigBank a security interest in its equipment. Typically, if BigBank wants to beat out competing third-party contenders, it will have to "perfect" this security interest—probably by filing a "financing statement" in the proper public records. If he fails to perfect, he will lose out to a competing creditor who gets a lien or share ratably with unsecured creditors.

Recall that the trustee is a kind of agent of creditors. So it is not surprising to learn that the trustee enjoys the rights of a lien creditor as of the petition date. In our case, this means that if the security interest is unperfected at the time of the bankruptcy filing, the trustee gets to set it aside. *See* §544(a)(1).

Preferences: Now, still another case. The debtor owes $10 each to the butcher, the baker and the candlestick maker. The debtor has assets worth only $10. He transfers all his assets to the butcher in satisfaction of the butcher debt, leaving the baker and the candlestick maker unpaid. What is the result? Observe that under the two rules we described above, it is probably bulletproof. There's nothing to indicate it could be set aside by a lien creditor. It (probably) wasn't done to defraud other creditors, and the debtor did get fair value for the payment (satisfaction of the $10 debt). Quite the contrary: Whatever the debtor did here, at least he paid a debt.

Preferring one creditor over another usually is not wrong outside bankruptcy. But bankruptcy is all about distributing assets among creditors "as their interests may appear." If you let the debtor pick and choose whom he pays, you may upset the purpose of bankruptcy. Thus, bankruptcy law allows a DIP to avoid certain pre-petition debt repayments even though they would not be avoidable outside of bankruptcy. *See* §547. Typical examples of preferential transfers include the late payment of a trade debt (outside the "ordinary course of business"), the granting of a security interest to a previously unsecured or under-secured lender, or delayed perfection of a security interest granted by the debtor at the time it incurred an earlier debt. The reach-back period for preferences is 90 days before bankruptcy, although it extends to one year if the recipient or other party who benefited from the transfer is an "insider" of the debtor (for definition of "insider," *see* §101(31)).

Vats of ink have been spilled over the trustee avoiding powers, and we don't do any more than hint at the difficulties here. More discussion of the topic must await Chapters 6 to 8. We raise the topic here mostly for one reason: The way you manage the avoiding powers may drive the chapter 11 case. In some cases, the avoiding powers provide the motive for filing—either to recover the transfer or to use the threat of doing so to reach a deal. On the other hand, there may be cases where the debtor and parties in interest will finesse the avoidance problems in order to make a deal that wouldn't happen otherwise.

Confirmation

Here is the basic chronology in confirming a plan:

- Negotiate a plan with creditors (or their agents).
- Draft a plan and its disclosure statement.
- Get court approval for the disclosure statement.
- Only after getting that approval, solicit votes from holders of impaired claims.

- Count the votes.
- Ask the court to confirm your plan.

Plan Formulation. Key to the timely confirmation of a plan is a well-defined exit strategy, preferably one known on or before the petition date. The plan proponent must determine what exactly it wants from the reorganization, and how, from a business perspective, it plans to achieve it. Most often, the chapter 11 plan is proposed by the debtor. And during the "exclusive period" (the first 120 days of the case, or longer if the court grants an extension—which it often does—but subject to a maximum of 18 months), the debtor has the sole right to propose a plan. But after the exclusive period expires, other parties may propose a plan. If you play this game long enough, you will see some plans proposed by creditors' committees, secured lenders and other parties. That is why we refer later on to the "plan proponent" rather than the "debtor."

Plans may, and frequently do, provide for comprehensive changes in the financial and business structure of the debtor. Such changes may include sales of assets, cancellation or refinancing of debt (or conversion of debt to equity), curing or waiving of defaults, satisfaction or modification of liens, amendment of the debtor's corporate charter, or changes in the amount, interest rate or maturity of outstanding debt.

A plan can provide that a creditor's claim will be reduced, or paid back over a greater period of time or at a different interest rate than was contained in the original instrument. Bankruptcy courts have confirmed plans with repayment periods of up to 20 years or longer. A plan can also cancel existing issues of stock, replace existing issues with new issues or swap equity for debt and vice versa.

Investors and would-be acquirers can use chapter 11 as a means for accumulating control of a debtor-corporation and for influencing the corporate governance of a debtor, taking actions that often would be more difficult outside the realm of bankruptcy. For example, articles of incorporation can be amended in a plan to change the voting rights of different issues of shares or modify anti-takeover measures.

The Disclosure Statement. No one may solicit acceptance of a plan until the court approves a "disclosure statement" sufficient so a voter can "make an informed judgment about the plan." *See* §1125(a)(1). The disclosure statement thus serves a function similar to a prospectus for an offering under securities law. (In addition, compliance with the disclosure statement requirements creates a limited safe harbor from certain securities laws requirements that would otherwise be applicable. *See* §1145).

Since no one can solicit consents without a court-approved disclosure statement, the hearing on disclosure typically becomes the first point of contact between the plan and the court. There are sometimes fights about the adequacy of the debtor's disclosure statement. Most of the time, these really have more to do with confirmation than disclosure issues. Objectors often see the disclosure statement hearing as a first chance to raise concerns about the plan. In response, judges often tell such objectors to "save it for the confirmation hearing."

One potential reaction to an objection seeking inclusion of additional information is for the debtor to request that the objecting party provide the specific language that they desire be inserted; there is a belief in some quarters that nobody reads the disclosure statement for disclosure: lawyers read the plan, which is controlling, and creditors read only the section of the disclosure statement that tells them what they will get and when they will get it. In fact, if the plan or disclosure statement contains an executive summary at the beginning, few creditors or interest holders may read further than that.

Solicitation. After the approval of the disclosure statement, the proponent solicits votes. Voting is done on a class-by-class basis. In order for a class to be deemed to have accepted a plan, the plan must be accepted by a majority in number of creditors who vote and at least two-thirds in debt amount of voting creditor claims in that class. For these purposes, the claims of insider creditors don't count. Nor do those that have been objected to unless they have arranged for the court to temporarily allow them for purposes of voting.

If every impaired class of creditors votes to accept the plan, the proponent then asks the court to confirm the plan. If no impaired class votes to accept the plan, then the plan is dead on arrival and the proponent must come up with something else, or head back to the bargaining table. If some impaired classes vote to accept and others vote to reject, then the proponent may seek to "cram down" the dissenting classes (see more about that below).

Basic tests for confirmation. Upon receipt of the necessary acceptances, the plan proponent will request the bankruptcy court to confirm the plan at the confirmation hearing.

The Bankruptcy Code requires the bankruptcy court to make a number of specific findings to "confirm" (approve) a plan and make it binding on all parties. These findings are found in §1129. They include determinations that the plan complies with all applicable law and has been proposed in good faith. *See* §1129(a)(1)-(3). The bankruptcy court must also determine that the plan is feasible (*i.e.*, that the debtor has a credible business plan and can reasonably be expected to perform its obligations and accomplish the objectives set forth in the plan). *See* §1129(a)(11).

If any individual creditor votes against the plan, then the plan must also pass the "best interests of creditors" test. *See* §1129(a)(7). This test requires the court to determine that the dissenting creditors or shareholders are receiving under the plan at least as much (in present value terms) as they would receive if the debtor were instead liquidated under chapter 7. It requires the court to compare (1) the probable distribution to the dissenting creditors or equity-holders if the debtor were liquidated with (2) the present value of the payments or property to be received or retained by the same creditors or equity-holders under the plan.

Stated more simply, if a class votes in favor of the plan, the plan will be binding on dissenters in that class as long as dissenting class members are getting at least as much as they would get in liquidation.

If a class of creditors votes to reject the plan, it may nevertheless be imposed on the class ("crammed down") if (1) at least one impaired class has voted to accept the plan, §1129(a)(10),

and (2) the court finds that the treatment provided for objecting classes under the plan does not "discriminate unfairly" and is "fair and equitable" (the "fair and equitable" test), §1129(b).

The prohibition against "unfair discrimination" means that, ordinarily, similar claims or equity interests must be treated in like manner. There are examples of "fair" discrimination, however. For example, the enforcement of a contractual subordination provision to subordinate the claims of one class to the claims of another class does not discriminate "unfairly" against the subordinated class.

The precise determinations required for meeting the fair-and-equitable test turn on whether the class is secured or unsecured. Cramdown of a secured class will be permitted if the plan provides (1) that the objecting secured creditor class will retain a lien to the extent of its secured claim and will receive deferred cash payments that have a present value equal to at least the value of the creditor's interest in the collateral, (2) for the sale of the secured creditor's collateral with the creditor's lien attaching to the proceeds or (3) for the realization by the secured class of the "indubitable equivalent" of its secured claim. (Nobody seems to know exactly what "indubitable equivalent" means, but one thing it may mean is turning over the secured creditor's collateral to it in satisfaction of the secured claim.)

The permutations of possibilities under the different cramdown options can become quite complex, but as a general rule they boil down to the secured creditor receiving at least the value of its collateral.

The fair-and-equitable test for unsecured claimants and shareholders is much simpler. Generally speaking, a class of unsecured claims can be crammed down if the plan provides either that the creditors in the class receive (over time) cash payments equal to the present value of their unsecured claims (*i.e.*, payment in full) or that junior classes (such as subordinated creditors or stockholders) receive nothing under the plan. Equity security-holders may be crammed down along similar lines. Cramdown cases are far more often threatened than confirmed, but the cramdown power provides important bargaining leverage.

Post-confirmation

Confirmation represents a significant achievement in a chapter 11 case, and it is generally viewed as the end goal of a chapter 11 filing. By entering a confirmation order, the court blesses the deal reflected in the plan and makes it enforceable; stated plainly, confirmation represents consummation of the business "deal" between the relevant parties. Confirmation, like chapter 11 itself, should not be the goal in and of itself. Rather, chapter 11 is a venue for getting to a deal and confirmation is akin to the signing of the contract that memorializes the deal.

However, confirmation does not end the case. A number of important aspects often remain to be completed after confirmation. This may include consummating transactions provided for in the plan, resolving claims, and litigating adversary proceedings. The case will be "over" when a final decree is entered by the bankruptcy court clerk, closing the case.