

How to Prepare Corporate and Individual Debtors for Bankruptcy

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CHAPTER 7 COUNSEL

DON'T BEE A DON'T BEE

By Ford Elsaesser

With apologies, (but no licensing fees paid), to Romper Room, we suggest that there are Ten Rules that Chapter 7 debtors should follow, so as to avoid becoming a DON'T BEE with regard to the highest standard of professionalism in representing individual Chapter 7 debtors. These Ten Rules are based upon experiences of a bankruptcy trustee in nearly 40,000 Chapter 7 cases over 32 years, and represent the most common mistakes, oversights, or “inattentive lawyering,” sometimes totally innocent that occur, and can almost always be avoided in most cases.

A guiding principal with credit to Donald Rumsfeld is that you “don’t know what you don’t know,” and the only way to extract that knowledge is to cover the waterfront with your prospective Chapter 7 debtor. It is our theory that if all Chapter 7 debtors’ counsel followed these Ten Rules, then passage through Chapter 7 will be much smoother, and for the debtor, ultimately rewarding—especially compared with the alternative.

Rule #1: DON'T BEE a Chapter 7 debtor’s counsel who does not thoroughly explore personal injury and other claims by the debtor. Every state has different exemptions with regard to personal injury and other claims (such as employment or discrimination) are claims held by the Chapter 7 debtors. One thing is certain, however; such claims are universally held to be property of the estate unless fully exempt (and without objection) or abandoned by the trustee. Problems often occur, however, when the Chapter 7 debtor is a member of a national or regional class action, but does not realize it either because he or she has not paid attention to class notices or simply does not understand the concept. As has been reported in many cases, the failure to disclose such a claim can result in judicial estoppel, preventing any recovery for the debtor, whether it involves a drug or surgical procedure class action or a personal injury lawsuit.

To avoid being a **DON'T BEE**, thoroughly examine the debtor, not only as to personal injury claims he or she may have, (but may not even have retained counsel for such, or otherwise pursued), as well as some of the more well-known current class actions in which he or she might be a participating class member. **DON'T BEE** a Chapter 7 debtor’s counsel who has to seek to reopen a case two or three years later to try to protect an otherwise estopped personal injury claim, and at the same time, try to maximize the exemption claim for your debtor. No amount of vetting on this issue is really too much.

Rule #2: DON'T BEE a Chapter 7 debtor’s counsel who does not thoroughly analyze the impact of separated and divorced spouses. Depending on state law, the filing by one spouse can have a significant impact on community or marital property, not only under § 541 of the Bankruptcy Code, but can have substantial impacts on the non-filing spouse or ex-spouse, while not benefiting at all.

A Chapter 7 debtor’s counsel cannot thoroughly analyze the impact of the dischargeability issues under § 523(a)(15) without reviewing the decree of divorce and analyzing its impact. Likewise,

with separated spouses who do not intend to jointly file, combining divorce and bankruptcy planning often make ultimate sense. As much as you hate family law, **DON'T BEE** a Chapter 7 lawyer who does not fully analyze the impact of a prior or pending divorce.

Rule #3: **DON'T BEE** a Chapter 7 debtor's lawyer who, due to the anxiety of the debtor(s) or the desire to book another case, does not fully explain the advantages of "waiting." As pointed out in some of the following Rules, in the absence of recurring garnishments, waiting can have a substantial beneficial effect for a myriad of reasons. **DON'T BEE** a Chapter 7 debtor's counsel who does not ask the debtors and himself or herself whether waiting will enhance the debtor's exemptions, avoid difficult avoidance claims, or even avoid the opportunity to avoid Chapter 7 in the future.

Rule #4: **DON'T BEE** a Chapter 7 debtor's attorney who does extreme exemption planning. What is extreme exemption planning? Courts have adopted varying standards, but experienced debtor's counsel and trustees know it when they see it. Few are troubled by taking a \$7,000 tax refund and buying a more-drivable vehicle than currently owned. Taking \$50,000 in nonexempt securities and transferring them into \$25,000 ROTH-IRA's for each spouse is bound to raise hackles and potentially subject the debtor to the impact of § 727 and/or § 548. If exemption planning makes sense from a state law perspective to protect execution and garnishment, then **DON'T BEE** a Chapter 7 debtor's lawyer who does not obey Rule #3—WAIT!

Rule #5: **DON'T BEE** a Chapter 7 debtor's attorney who does not review one of the freely-available credit reports of the debtor to ensure that the Schedules, particularly Schedule F, identify all creditors. Further, **DON'T BEE** a Chapter 7 debtor's lawyer, when in doubt, who does not name the Internal Revenue Service and the state taxing authority as Schedule F creditors, just in the occasional, (but common) circumstance where the Internal Revenue Service or state taxing authority has an unsecured, non-priority claim that the debtor has forgotten about or otherwise ignored. Being thorough in this area saves Schedules amendments, and more expensive, later motions to reopen the case to include omitted creditors.

Rule #6: **DON'T BEE** (since 2005) a Chapter 7 debtor's attorney who does not thoroughly analyze the impact of § 522 with regard to the debtor's residency. The residency requirements for which exemptions are appropriately claimed can create absurd and sometimes harmful results for the debtor, if not carefully analyzed. A homestead exemption of \$100,000 that totally protects the debtor's equity under state law may be worthless to a debtor who lived in a low exemption state under § 522. At the very least, analyze what adoption of Rule #3 (WAIT!) might do to maximize the debtor's ability to claim exempt property.

Rule #7: **DON'T BEE** a Chapter 7 debtor's lawyer who ignores the impact of LLC's owned by the debtor. Many small business and home business Chapter 7 debtors, unfortunately, due to media and Internet advertising, are convinced they needed to create one or more corporations, or in the modern era, LLC's. To the extent assets are on the books of an LLC that might otherwise be exempt under state or federal wildcard, tools of the trade, professional instruments, etc., exemptions, have no exempt-ability when they have been put on the books of the LLC. And, by the way, saying "d/b/a or f/d/b/a" does not work, either.

If there are assets of value in the LLC that, if owned by the individual, could be claimed as exempt, then take the simple approach (in most states) of dissolving the LLC, and vest the assets back in the debtor.

Rule #8: DON'T BEE a Chapter 7 debtor's attorney who files on a small amount of unsecured debt, when the debtor is neither being sued nor garnished. All Chapter 7 trustees have seen far too many cases where debtors have filed Chapter 7 on relatively nominal amounts of debt, in situations where they are neither being garnished nor sued by a collection agency. For the same fee that you charge for filing a Chapter 7, you could probably compromise most of the unsecured debt to small percentages, or simply counsel the debtor to avoid the nasty phone calls, much easier today in the era of few land lines or smart phones, as well as the ability to block calls and emails. If the debtor has a major uninsured medical expense two years later and truly needs Chapter 7 when the collection agency for a dozen different medical providers are garnishing 25% of his or her take-home wages, he or she will thank you for being a proud adopter of Rule #3—**WAIT!**

Rule #9: DON'T BEE a Chapter 7 debtor's counsel, who in states where tax refunds are not exempt, does not drill the tax refund turnover principles into the debtor repeatedly, or counsel the debtor to wait until the refund has been utilized on exempt assets or living expenses. Every year, in some jurisdictions, multiple debtors lose their discharge by not turning over their tax refunds, and spending it on what are legitimate "urgent" expenses. If your debtor cannot wait until the refunds have been received and appropriately spent before filing, then extract, in blood if necessary, a promise that the refunds will be brought directly to your office to avoid the very real possibility of having the discharge go up in smoke.

Rule #10: DON'T BEE a Chapter 7 debtor's lawyer who does not analyze the impact of preferential transfers and § 548 transfers on the family and friends (and sometimes employers) of debtors. Often Chapter 7 debtors, in the two years before bankruptcy, make transfers (often with exempt property) to repay family and friends who have helped them out. A typical example would be that the debtor receives a \$5,000 tax refund that, depending on the state, may be exempt, or could otherwise be used to acquire exempt assets or simply pay some living expenses, such as rent, utilities. Instead the debtor pays Mom and Dad the \$5,000 that the parents loaned the debtor. If that happened within a year, it may very well be preferential. Similarly, gifts to parents, siblings and children can create significant exposure. Be sure to thoroughly cover with the debtor, beyond what is set out in the legal-eeze of the Statement of Financial Affairs, every repayment or other transfer that might create exposure to family and friends that the debtor clearly does not want to see occur. Absent continuing garnishments, the solution is, as almost always is, to adopt Rule #3—that is, **WAIT!**

HOW TO PREPARE CORPORATE
AND INDIVIDUAL DEBTORS FOR BANKRUPTCY
ABI SOUTHWEST CONFERENCE
SEPTEMBER 11-12, 2015
LAS VEGAS, NV

ISSUES IN REPRESENTING THE INDIVIDUAL CHAPTER 11 DEBTOR

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Initial Interview

- Know Your Client
 - Why is the client contemplating filing?
 - Identify issues that need to be addressed
 - Get the “big picture” – the debt structure
 - Discuss alternatives to bankruptcy
 - Review and analysis of reasons **not** to file
 - Review and analysis of reasons to file
 - Discuss alternative chapters
 - Decide where and when to file

Initial Interview

- ⦿ Information requests to potential client
- ⦿ Financial information
 - For Schedules
 - For SOFA
 - For Petition
- ⦿ Personal information
 - Family, income, expenses, books and records, prior or pending bankruptcy cases, pending or threatened litigation, exemptions

Retention/Engagement Letter

- ◎ Terms of Engagement for Filing with Court
 - Prepare and, if necessary, file a Chapter 11 Petition with U S Bankruptcy Court
 - If file, terms of engagement subject to Bankruptcy Court approval
 - If Court declines to approve, or case converted or trustee appointed, reserve right to withdraw and return balance of retainer after satisfaction of any outstanding invoices for services rendered

Retention/Engagement Letter

- ◎ Scope of Services
 - Rights, powers, duties of DIP
 - DIP financing, debt restructuring, cash collateral orders
 - Review agreements re: business and property
 - Review liens including enforceability
 - Recovery of property for the estate
 - Prepare all filings – review schedules and applications
 - “First Day Orders”

Retention/Engagement Letter

- Scope of Services/cont'd
 - Counseling re: plan of reorganization
 - Legal services necessary and appropriate for administration of estate
 - Exclusions
 - Adversary proceedings
 - Litigation
 - Arbitration
 - Mediation

Retention/Engagement Letter

- ⦿ Attorney Client Privilege
 - Communications between attorney and client are privileged
 - Remember -- who is the client?
 - Attorney work product is privileged
 - Potential for waiver of privilege upon appointment of a Trustee

Retention/Engagement Letter

- Fees and Costs
 - General Retainer
 - Effective upon funds clearing
 - No filing until funds clear
 - Reasonable Fees
 - Hourly rates
 - Additional matters
 - Court determines reasonableness
 - Fee application process
 - Staffing Discretion

Side Letter (Not to be Filed)

- Operating in Chapter 11
 - Debtor-in-Possession
 - Fiduciary and manager of estate assets
 - Do nothing to diminish estate
 - Salaries/draws/daily expenses
 - New security interests
 - Extraordinary expenses

Side Letter (Not to be Filed)

- Guidelines for DIP
 - ***Do not do the following*** without consulting us and obtaining Court approval
 - Retain professionals, contractors, or consultants
 - Pay prepetition debts
 - Engage in insider transactions
 - Fail to disclose assets, bank accounts, etc.
 - Assure creditors of payment
 - Make gifts (even to charities)

Side Letter (Not to be Filed)

- ◉ Guidelines for DIP/cont'd
 - ***Do not do the following*** without consulting us and obtaining Court approval
 - Offer, give, or accept payments that could be interpreted as bribes
 - Make transfers other than for reasonably equivalent value or outside of ordinary course
 - Make advances other than actual, anticipated expenses
 - Engage in speculative ventures

Side Letter (Not to be Filed)

- Guidelines for DIP/cont'd
 - ***Do not do the following*** without consulting us and obtaining Court approval
 - Sell assets out of ordinary course
 - Extend credit
 - Borrow or grant liens
 - Pay secured debt
 - Permit repossession
 - Affirm debts
 - Pay prepetition taxes

Side Letter (Not to be Filed)

- Guidelines for DIP/cont'd
 - ***Do the following***
 - Maintain insurance
 - Protect and preserve assets
 - Maintain books and records
 - Maintain tax accounts (e.g. FICA)
 - Notify creditors and litigants of the filing
 - Notify counsel of government investigations
 - Change bank accounts to “DIP”

Side Letter (Not to be Filed)

- Guidelines for DIP/cont'd
 - *Do the following*
 - Transfer accounts to authorized depositories
 - Do not exceed federally insured maximums
 - Document postpetition withdrawals and expenditures
 - Segregate trust funds
 - Refer legal inquiries to counsel
 - Prepare and follow monthly budget
 - Document expenditures per budget

Side Letter (Not to be Filed)

- Guidelines for DIP/cont'd
 - ***Do the following***
 - Pay lease rents, taxes, utilities, approved secured debt on a current basis
 - Review executory contracts and leases with counsel for assumption or rejection
 - Note – 60-day deadline for assumption or rejection of non-residential real property leases

Side Letter (Not to be Filed)

- DIP is liable for post-petition wrong doing – including failure to fulfill statutory obligations as DIP
- Remedies include
 - Dismissal of case
 - Conversion to Chapter 7
 - Appointment of Trustee
 - Criminal referral

Counsel's Obligations

- ◎ Who is your client?
 - Individual Debtor or Estate?
 - Repercussions of failing to represent estate
- ◎ Keep your client informed
 - No surprises
- ◎ Obligations upon conversion or appointment of Trustee
 - Continuing fiduciary duties
 - Exiting the case
 - Limitations in Retention Agreement

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HOW TO PREPARE CORPORATE
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Chapter 11 Filing Preparation

Jessica C.K. Boelter

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SIDLEY

TALENT. TEAMWORK. RESULTS.

Situation Assessment; Consideration of Alternatives

- Assess Company's Restructuring Needs: Balance Sheet, Operational, Immediate Liquidity, Industry Downturn, Catastrophic Event
 - Consider Alternatives (Including Non-Bankruptcy Alternatives):
 - Out-of-court business turnaround
 - Asset sale (in or out-of-court)/equity infusion
 - Exchange offer
 - Exchange offer “backed” by a prepackaged plan
 - Prepackaged or pre-negotiated plan
 - Assignment for the benefit of creditors
 - Receivership, federal and state
 - Handing over the keys – collateral enforcement
 - Chapter 11 without pre-determined exit
-

Chapter 11: Pre-Filing Strategic Planning and Analysis

- Professionals—retention and funding
- Determine which entities to file
- Consider whether foreign proceedings are necessary
- Determine appropriate time for filing
- Determine appropriate venue for filing
- Review and analyze all debt documents, CBAs, material contracts
- Assess regulatory implications and strategy
- Analyze tax position and consider whether NOL preservation is necessary

Chapter 11: Pre-Filing Strategic Planning and Analysis Cont.

- Liquidity analysis and cash forecast to determine funding needs during chapter 11
- DIP facility sizing, solicitation and negotiation
- Analyze liquidity impact, if any, on non-filing entity operations
- Identify and evaluate post-petition implications of intercompany transactions
- Cash management planning
 - Consider isolating filing entities' activities from non-filers
 - Timing of important payments (e.g., payroll)
 - Identify automatic payments/wire transfers and consider arrangements to discontinue, if necessary
 - Develop system to prevent inadvertent payment of prepetition claims
- Develop procedures to close prepetition books and records as of the Petition Date

Chapter 11: Pre-Filing Strategic Planning and Analysis Cont.

- Communications program for customers, employees, vendors, other constituencies
- Identify and evaluate filing implications for labor and retiree benefits
- Extensive diligence for potential first day filings
 - Develop understanding of all matters related to potential “first day” pleadings and related documents to assess relief that will be sought on the “first day”. See Part II below
 - Recommend diligence questionnaire or tracking spreadsheet for each first day filing and motion
- Corporate governance
 - Obtain and review corporate governance documents
 - Board meetings and authorizations
 - Memorandum concerning fiduciary duties, chapter 11 process
- Evaluate exit strategies

Preparation of Pleadings and Related Documents

- Authorizing Resolutions
- Voluntary Petition and Related Documents
- Consolidated List of 20/30 Largest Creditors
- Creditors Matrix
- List of Equity Security Holders
- Cash Management Motion
- DIP Financing/Cash Collateral Motion

Preparation of Pleadings and Related Documents Cont.

- Critical Payments Motions
 - Employee Wage
 - Customer Programs/Accommodations
 - Essential Vendors/503(b)(9)
 - Foreign Vendors
 - Brokers
 - Shippers, Warehousemen, Lien Claimants
 - Taxes
 - Insurance
- Utility Motion
- Other Matters that May Require Emergency Relief

For Notes

1




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20 WAYS TO PREPARE
MANAGEMENT FOR
BANKRUPTCY'S...

GAME OF THRONES



"Fear cuts deeper than swords."
– George R.R. Martin, *A Game of Thrones*

For Notes

3

THE DIRTY DOZEN

"Most men would rather deny a hard truth than face it."



– George R.R. Martin, *A Game of Thrones*



The Dirty Dozen - #1

4

1. *Your denial will kill you*



For Notes

The Dirty Dozen - #2

5

2. *Listen to experienced first responders*



IF3

The Dirty Dozen - #3

6

3. *Being in a zone, puts you on a target*



IF3

For Notes

The Dirty Dozen - #4

7

4. *Train yourself on fundamentals*

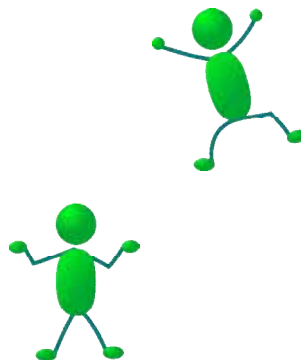


IF₃

The Dirty Dozen - #5

8

5. *Everything private will be public*



IF₃

For Notes

The Dirty Dozen - #6

9

- 6. *You are not ready no matter how ready you are***



IF3

The Dirty Dozen - #7

10

- 7. *The next thing you hear will be a giant sucking sound***



IF3

For Notes

The Dirty Dozen - #8

11

8. *Your life will be defined by deadlines*



F3

The Dirty Dozen - #9

12

9. *This blind date may turn out awkwardly*



F3

For Notes

The Dirty Dozen - #10

13

10. Playing in a sandbox

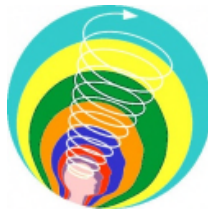


IF₃

The Dirty Dozen - #11

14

11. Employee "Death Spiral"



IF₃

For Notes

The Dirty Dozen - #12

15

12. *Star players become free agents*



16

BEHIND THE EIGHT BALL

*"A mind needs books as a sword needs a
whetstone, if it is to keep its edge."*

– George R.R. Martin, *A Game of Thrones*



For Notes

Behind the Eight Ball - #1

17

1. Show me the money



IF₃

Behind the Eight Ball - #2

18

2. The affair is over, come clean with your lender



IF₃

For Notes

Behind the Eight Ball - #3

19

3. Collateral means collateral



F3

Behind the Eight Ball - #4

20

4. Take a DIP



F3

For Notes

Behind the Eight Ball - #5

21

5. Spend some time on the SOFA



IF₃

Behind the Eight Ball - #6

22

***6. Know your way out before
you enter that door***



IF₃

For Notes

Behind the Eight Ball - #7

23

7. Preference is prohibited



IF₃

Behind the Eight Ball - #8

24

8. Paint your picture




IF₃

For Notes



Any Additional
Questions?



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