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Lecture 23: 5/10/04

Guest: John Whitlock, Partner, Palmer & Dodge

Bankruptcy:

1.) you decide to go
2.) or are thrown into bankruptcy by creditors

- reorganization track or liquidation track
- basics on how chapter 11 works is crucial
- lender has mortgage on building, he can push you to bankruptcy
- how do you reorganize your business?
  - Building worth greater than loan
- bankruptcy judges are former lawyers
  - specialized jurisdiction. They usually handle routine liquidations.
- cram down a plan
  - In bankruptcy you must provide an affirmative vote from a class creditor for the plan.
- The first 120 days in bankruptcy: when debtor has exclusive right to the plan
  - This can be extended, never shortened.
- If one creditor sells loan on a discount, then one party may lose out.
- Unsecured: usually on 14 cents on the dollar.
- Unless the manager puts in more money, he won't get a higher equity stock.
- Usually creditor's get lion share of the equity.
- Most bankruptcy has a lot of debt. They have to convince creditors that in the future they will be viable and that they should NOT liquidate.
- There are facets to this negotiation.
- A small business with few creditors who see that your success going forward is likely→ if you got 90% of creditors to agree then you can weather a storm. If not, you can do a prepackaged Ch. 11 plan: a good plan in creditors' eyes: approved by bankruptcy court: takes 2 or 3 months.
- It must have force of creditors and then you can give it to the opposing creditors (chapter 11 forces t his on the minority).
- What if the building is worth less than the debt?
  - Secured creditor is not secured
  - Dismiss bankruptcy case

- Now you go into Ch. 11
- First day orders
- Who will you deal with?
  - Representatives of your secured debt.

- If they are at least creditors willing to serve on the creditors' committee
    - They are authorized to hire their own council
        - Paid as expense if administration
        - This could be expensive.
- Key players: Chairman of committee; committee council; creditor's council
- Negotiation process then proceeds after the committees are formed.
- Creditors want to pay the smallest amount for negotiation.
- A lot of equipment is financed on a lease: the debtor must meet the terms of the lease.
- You can have true lease or finance lease of equipment
- Bankruptcy: you can sell assets in Chapter 11, before the plan, or you can do it after.
- You can reject stores that are dong badly, and then deal later with the unsecured debtors.
- 90 days before bankruptcy is when you can give preferences.
- The court can appoint a trustee in a Chapter 7.
- "examine": does not have power of trustee
    - he reports facts, wrong-doings

- value of companies assets
    - the creditors can make up with their own plan if they want to after the 120 day period. This is rare.
        - "competing plans."
- "Stalking horse bidder": a bidder who comes in as the initial bidder who may realize that they are not the highest bidder; the court may help them if he does not succeed.
    - Stalking horse premiums: make it less economical for others, because now they have to pay that premium.
- When you buy assets in an auction, you get them free of leans.
- A sale for less than fair value is a fraudulent conveyance.
- Role as a manager when your company is sliding into bankruptcy.
- If a company is insolent, shareholders have little interest in company—now only creditors care.
    - Duty shifts to the creditors.
    - Need to minimize loss to creditors.

- LBO: when management raises money to buy the company (pay off existing shareholders)
- Before: company has no debt, but lots of equity.
- After: company with debt and some equity.
- In order for fraudulent conveyance to succeed, the court needs to be convinced that the reasonable creditors couldn't make it work from the get-go.