Bankruptcy: Overview of the Chapter 11 Process

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This Practice Note describes the various types of Chapter 11 cases, the powers, protections and advantages of Chapter 11, the disadvantages of Chapter 11, and the administrative and business stages of a typical Chapter 11 case.

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ABI Commission to Study the Reform of Chapter 11

Chapter 11 of the **Bankruptcy Code** provides a procedure which allows a debtor to continue operating its business while it either formulates a **plan of reorganization** with its creditors or **liquidates** its affairs. It is available to most corporations, **partnerships**, and **limited liability companies** (LLCs), as well as to foreign companies recognized under **Chapter 15** with assets in the US. Chapter 11 is also available to individuals, but these cases are rare, and are usually limited to individuals with complex financial affairs (see Practice Note, Individual Chapter 11 Bankruptcy: Overview).

The primary alternatives to Chapter 11 are:

- A liquidation under **Chapter 7** of the Bankruptcy Code (see Practice Note, Chapter 7 Liquidation: Overview).
- An **out-of-court restructuring** (see Practice Note, Out-of-Court Restructurings: Overview).

This Note discusses the various types of Chapter 11 cases, the pros and cons of Chapter 11, and the administrative and business stages of a traditional Chapter 11 case.

Types of Chapter 11 Cases

There are three basic types of Chapter 11 cases:

- Traditional (see Traditional (or "Freefall")).
- **Prepackaged** (see Prepackaged (or "Prepack")).
- Pre-arranged (see Pre-Arranged (or Pre-Negotiated)).

Traditional (or "Freefall")

In a traditional bankruptcy case, the troubled company does not have any restructuring agreements with its creditors prepared before the filing of the bankruptcy petition in the bankruptcy court. A traditional filing is often in response to significant **liquidity** and **cash flow** issues, such as the inability of the company to pay its bills or the company's **insolvency**.

Sometimes the filing is preceded by failed out-of-court negotiations with creditors. The debtor then "freefalls" into the bankruptcy system without any restructuring arrangements with its creditors in place. During the process, the debtor engages its various constituents (such as creditors, suppliers, employees, and customers) and uses the tools of Chapter 11 to restructure its operations and **balance sheet**.

A traditional Chapter 11 case may be voluntary or **involuntary**:

- **Voluntary.** The **board of directors** authorizes the debtor to file the bankruptcy petition. An **order for relief** entered by the bankruptcy court immediately puts the debtor in bankruptcy. There is no requirement that the debtor be insolvent.

- **Involuntary.** The petition is filed by creditors. If the debtor has more than 12 **unsecured creditors**:

  - the petition must be filed by at least three unsecured (or **undersecured**) creditors; and

  - the filing creditors' **noncontingent**, undisputed **claims** added together result in at least $18,600 in **unsecured claims** (§ 303(b), Bankruptcy Code).

  If there are fewer than 12 unsecured creditors, then just one creditor holding an unsecured claim of at least $18,600 may initiate the case. If a creditor has a claim for less than $18,600 he may join with another creditor to satisfy the $18,600 requirement to file the petition.

  The filing triggers the **automatic stay** but the debtor is not immediately put in bankruptcy because the debtor may contest the petition. If the debtor contests, the court must enter the order for relief if either:

  - the debtor is generally not paying its debts as they become due; or

  - a custodian was appointed, or took possession of, substantially all of the debtor's property within 120 days before the **petition date**.

  Involuntary cases are uncommon. For more information, see Practice Note, The Involuntary Bankruptcy Process.

Traditional bankruptcies are the most common type of bankruptcy. The main advantages are:

- The protection of the automatic stay (see Automatic Stay).

- The ability to restructure business operations through the power to reject unfavorable **executory contracts** and leases (see Executory Contracts and Leases).

- The power to impose a restructuring plan on non-consenting creditors (see Non-Consenting Parties).

However, traditional bankruptcy proceedings are usually more prolonged, and consequently more expensive, than prepacks and pre-arranged bankruptcies discussed below.

Prepackaged (or "Prepack")

Legally, a prepackaged bankruptcy is the same as a traditional bankruptcy, except for the sequence of events. In a prepack, a plan of reorganization is drafted, negotiated, and voted on by creditors before the filing of the case. It is a consensual process where most of the work, including voting, is done before the debtor is in bankruptcy.

The debtor circulates the plan, the **disclosure statement** (which describes the debtor's history and explains the risk factors of the proposed restructuring plan) and ballots to creditors, who vote after they have had sufficient time to review the documents. If the plan is accepted by two-thirds of the dollar amount of the claims actually voting on the plan and a majority in number of the creditors actually voting on the plan for each **impaired class**, the debtor simultaneously files the petition, the plan, the disclosure statement, and the ballots. Impaired classes are those whose legal, equitable, or contractual rights are altered in any way by the plan, whether or not the change was adverse (see Practice Note, Reinstatement of Prepetition Loans in Bankruptcy: What is Impairment?).

The main advantages of a prepack are:

- **Speed and cost-effectiveness**. If approved, the debtor can be out of bankruptcy in a matter of weeks, dramatically reducing the costs and risks of the Chapter 11 process and minimizing disruption to its business. Also, spending less time in bankruptcy is beneficial to companies that are concerned with their public image (for example, retailers (see Practice Note, Retail Industry Bankruptcies: Overview)).
- **Greater control**. The debtor has more control over the process than in a traditional bankruptcy, as the plan is finalized before the debtor submits to the jurisdiction of the bankruptcy court.
- **Binding dissenters**. Prepacks can bind dissenters who block an out-of-court restructuring (so-called "holdouts"). An out-of-court workout can be structured as a prepack but, if holdouts block the deal, it can then be filed in court as a prepackaged bankruptcy case. Holdouts are bound to a prepackaged plan which is supported by sufficient majorities of creditors in a bankruptcy.

The main drawbacks of prepacks are:

- **Upfront investment**. They require an up-front investment of time and resources to draft, negotiate, and vote on a plan. The voting requirements must be satisfied before the filing, a challenge which depends not only on consensus, but also on the size and concentration of the creditor group.
- **Retroactive approval**. There is a risk that the debtor will have to resolicit votes if the court disapproves the disclosure statement. This can be expensive and cause delay.
- **Ongoing operational issues**. Prepacks are not ideal for debtors with operational, rather than financial, problems, as they forgo the opportunity to discover and address business, management, product, market, regulatory, and other non-financial issues using the special powers of Chapter 11, such as the ability to reject unfavorable executory contracts (see Powers, Protections, and Advantages of Chapter 11). A longer stay in Chapter 11, while involving significant risk and expense, would give the debtor time to reevaluate and fine-tune its business plan, allowing it to emerge as a stronger company. The chance that the debtor would have to re-file, which often entails liquidation, would be reduced.

Prepacks were less common than traditional bankruptcies, as they are only appropriate when the parties can agree in advance on a restructuring solution, and this solution does not require resolving operational issues. While the idea of a quick and successful exit from bankruptcy is appealing, implementing a prepack is difficult. In recent years, however, the use of prepacks has grown significantly such that prepacks, together with pre-arranged cases (see Pre-Arranged (or Pre-Negotiated)), account for most cases that emerge from Chapter 11 through a **confirmed reorganization** plan.

For more information on prepacks, see Practice Note, The Prepackaged Bankruptcy Strategy and Timeline of a Prepackaged Bankruptcy Case.

Pre-Arranged (or Pre-Negotiated)

A pre-arranged bankruptcy is a hybrid between a traditional bankruptcy and a prepackaged bankruptcy. As with a prepack, a restructuring deal is negotiated with major creditors before filing the petition. However, as with a traditional bankruptcy, solicitation of votes occurs after the case has been filed and after the court has approved a disclosure statement.

Often, in the place of a vote (which would be obtained in a prepack), the debtor and certain creditors enter into a "lock-up" or "plan-support" agreement which sets out the basic terms of the restructuring, such as new terms for their debt or additional financing (see Practice Note, Restructuring Support Agreements in Bankruptcy). This commitment may or may not be binding depending on the terms of the agreement.

Once the debtor has secured the support of its major creditors, it will file the Chapter 11 petition and move through the bankruptcy process relatively quickly (faster than a traditional case, but slower than a prepack).

The main advantage of a pre-arranged case over a traditional case is a shorter time in bankruptcy, as the groundwork is laid with the creditor body before the filing. Also, unlike a prepack, a formal plan and disclosure statement are prepared only if the bankruptcy is filed, lowering up-front costs.

As mentioned above, prepacks involve the risk that votes will have to be resolicited if the court disapproves the disclosure statement. There is no such risk in a pre-arranged case because voting does not occur until the court approves the disclosure statement.

Pre-arranged bankruptcies are not as common as traditional cases, as they require the commitment and support from the creditor group before the bankruptcy. However, in recent years, the use of pre-arranged cases has significantly grown such that, together with prepacks (see Prepackaged (or "Prepack")), they account for most cases that emerge from Chapter 11 through a confirmed reorganization plan.

Powers, Protections, and Advantages of Chapter 11

A debtor wanting to reorganize its business has two alternatives:

- Chapter 11 business **reorganization**.
- Out-of-court restructuring (see Practice Note, Out-of-Court Restructurings: Overview).

The Bankruptcy Code provides numerous powers and protections which are only available to Chapter 11 debtors, making Chapter 11 the only viable strategy for some companies facing severe financial crisis.

Automatic Stay

The most important benefit of Chapter 11 is protection from creditors and suspension of pending litigation due to the automatic stay. The automatic stay is triggered immediately on the filing of the bankruptcy petition. It automatically stops almost all acts and proceedings against the debtor, including virtually all creditor collection activities. The automatic stay gives the debtor a breathing spell so that it can address its business problems and reorganize its affairs without interference and pressure from creditors.

For more information on the automatic stay, see Practice Note, Automatic Stay: Overview.

Preserving Going Concern Value

The Chapter 11 process generally provides the debtor with an opportunity to preserve the **going concern** value of its business. A successful reorganization can enhance the value of the debtor's assets functioning together as a unit. Value is lost when the company is liquidated or torn apart by individual creditors exercising remedies against **collateral**.

Executory Contracts and Leases

Once in Chapter 11, the debtor can reject burdensome executory contracts and unexpired leases and preserve the value of favorable ones (see Practice Note, Executory Contracts and Leases: Overview). An executory contract is a contract which is substantially underperformed on both sides or where both parties have continuing obligations to perform. Typical examples include joint development agreements and manufacturing agreements. Debtors may use the threat of rejection to gain leverage in negotiating more favorable terms. Any damages resulting from rejection claims are paid at cents on the dollar, and lease rejection damages are capped (see Practice Note, Executory Contracts and Leases: Overview: Rejection).

Prepetition Debt and Postpetition Financing

A Chapter 11 debtor is relieved from making scheduled principal payments on debt to both its secured and unsecured creditors. It is also excused from making interest payments to unsecured creditors (see Practice Note, Postpetition, Fees, Costs, and Charges in Bankruptcy: Undersecured and Unsecured Creditors' Rights to Postpetition Interest). To continue operations, the debtor may obtain **DIP financing** which is a new loan that potentially has **priority** over all existing claims, including **secured claims**.

For more information on DIP financing, see Practice Note, DIP Financing: Overview and Timeline of DIP Financing Process.

Preferences and Fraudulent Transfers

Chapter 11 provides for the debtor's ability to recover certain payments it made before the bankruptcy, if it can prove a **preference** or **fraudulent transfer**:

- A preference is a transfer made by the debtor within 90 days of the bankruptcy filing, when the debtor was insolvent, to or for the benefit of a creditor on account of a preexisting debt, if the transfer enabled the recipient to receive more than it would if the debtor were liquidated under Chapter 7 and the transfer had not been made (see Practice Note, Preferential Transfers: Overview and Strategies for Lenders and Other Creditors). Preference payments to **insiders**, such as directors, officers, and **general partners** of the debtor, are recoverable if made within one year before the filing of the bankruptcy petition.

- Fraudulent transfers are transfers made by the debtor within two years (under the Bankruptcy Code) or other time limit set by state law, with actual intent to hinder, delay, or defraud creditors and transfers made by the debtor for which the debtor did not receive reasonably equivalent value in return (see Practice Note, Fraudulent Conveyances in Bankruptcy: Overview).

Asset Sales

Another advantage of Chapter 11 includes the potential to receive higher prices for asset sales due to the ability to convey exceptionally clean title. A sale order issued by the bankruptcy court can authorize the sale of the debtor's property free and clear of all **liens** and most claims, subject to certain requirements. For more information on asset sales in bankruptcy, see Practice Note, Buying Assets in a Section 363 Bankruptcy Sale: Overview and Timeline of a Section 363 Sale.

Guaranties

Chapter 11 debtors enjoy relief from exposure under guaranties of obligations of, or **joint and several** obligations with, financially troubled **affiliates**.

US Federal Income Tax Benefits

Chapter 11 offers many US federal income tax benefits to individual and corporate debtors. The debtor's **net operating losses** (NOLs) may be preserved and the debtor generally has no tax liability on **cancellation of indebtedness income** (CODI).

- **NOLs.** A taxpayer has a NOL when its allowable deductions exceed its gross income in a specific taxable year. For NOLs arising for taxable years ending on or before December 31, 2017, NOLs can generally be carried back two years and carried forward up to 20 years to offset taxable income (IRC § 172). The **Tax Cuts and Jobs Act** (TCJA) eliminated the carryback of NOLs for NOLs arising in taxable years ending after December 31, 2017, allowed an indefinite carryforward of these NOLs, and generally limited the use of post-2017 NOLs to 80% of taxable income. However, the **Coronavirus Aid, Relief, and Economic Security Act** (CARES Act) temporarily suspended the elimination of NOL carrybacks, allowing taxpayers to carry back NOLs arising in taxable years beginning after December 31, 2017 and before January 1, 2021 to the previous five taxable years and repealed the 80% income limitation for taxable years beginning before January 1, 2021. A debtor may be able to preserve any NOL carryforwards remaining after a Chapter 11 reorganization. However, there is a special rule in IRC Section 382 that limits the use of NOL carryforwards after certain corporate ownership changes (IRC § 382(g)) and a corporate debtor's plan of reorganization frequently causes such an ownership change. There is a bankruptcy exception to this NOL limitation rule for ownership changes resulting from a plan of reorganization (providing generally that a corporate debtor's use of NOL carryforwards will not be limited by IRC Section 382 if the reorganized corporate debtor is 50% or more owned by the debtor's old shareholders and "qualified creditors") but it may be difficult to satisfy (IRC § 382(l)(5)). Also, CODI often reduces a debtor's NOL carryforwards (see below).

- **CODI.** Outside bankruptcy, the debtor generally must include the cancelled amount of debt in gross income for US federal income tax purposes. Inside bankruptcy, CODI is generally excluded from gross income, although certain tax attributes of the debtor must be reduced to offset this benefit (such as NOLs, NOL carryforwards, various tax credits, **capital losses**, and the **basis** of certain property). NOLs attributable to the year of **discharge** and NOL carryforwards are reduced first (unless the debtor elects to first reduce the basis of **depreciable** property) (IRC § 108).

Non-Consenting Parties

Chapter 11 enables the debtor to impose a restructuring plan on non-consenting parties, if the voting requirements are met (see Proposal and Confirmation of Plan of Reorganization). Alternatively, a restructuring plan may be forced on dissenting parties if the **cramdown** test is satisfied.

A plan may be "crammed down" if all of the following apply:

- At least one impaired class has voted to accept the plan.
- The plan does not "discriminate unfairly" against the impaired class objecting to the plan. This generally means that similar claims or interests are treated similarly.
- The plan is "fair and equitable" concerning the impaired class objecting to the plan:
  - regarding **secured creditors**, this generally requires that the secured creditor receive at least the value of its collateral;
  - regarding unsecured creditors and stockholders (or other **equity** holders), this generally requires that members of the dissenting class be paid the allowed amounts of their claims in full before any class junior to such dissenting class receives any **distribution**.

For more information on cramdown, see Practice Note, Chapter 11 Plan Process: Overview: Confirmation of a Plan: Cramdown Plans.

Disadvantages of Chapter 11

While there are many benefits to Chapter 11, there are also many risks, burdens, and obligations which make Chapter 11 a last resort. An out-of-court restructuring is the more attractive option for a debtor who has the luxury of choice and does not need the unique benefits provided by Chapter 11 (see Powers, Protections, and Advantages of Chapter 11).

Cost

Chapter 11 is usually more expensive than an out-of-court workout. Not only must the debtor pay fees for its own attorneys and other professionals (such as an investment banker, accountant, or other financial consultants), but it must also bear the cost of professional fees for the **creditors' committee**. Attorneys' fees in a small case can range from $50,000 to $150,000, but can be as high as several million dollars, depending on the size of the case. Bankruptcy attorneys may even require their fees to be paid upfront as prepayment retainers, given the company's financial condition.

Loss of Control

Management personnel of the debtor risk being displaced by the appointment of a **Chapter 11 trustee** or by a **Chapter 7 case trustee** (see Practice Notes, Appointing or Electing a Chapter 11 Trustee and Duties of a Chapter 7 Bankruptcy Trustee Under Section 704 of the Bankruptcy Code), if the court **converts** the case to Chapter 7 (see Practice Note, Dismissing or Converting a Chapter 11 Case to a Chapter 7 Case). Although it rarely happens, a Chapter 11 trustee can be appointed by the court to run the business if there is fraud or gross mismanagement by the debtor's management (see Practice Note, Serving as a Chapter 11 Trustee: Operating the Debtor's Business).

Court Approval

The debtor must seek the court's approval for all decisions outside the **ordinary course of business**, such as the sale of significant assets or the rejection of material contracts.

Public Image

Chapter 11 is a public and transparent process. The debtor is subject to increased public scrutiny. It is potentially stigmatizing and may result in a fall in the public's confidence in the company. This in turn may negatively impact customer and vendor relationships, and cause difficulty in retaining employees.

Risk to Equity

Creditors are entitled to be paid first in Chapter 11 (see Practice Note, Order of Distribution in Bankruptcy: Order of Payment and Diagram: Order of Distribution in Bankruptcy). If there are not enough resources to pay all creditors in full, stockholders (or other **equity holders**) of the debtor risk losing their residual stake in the company to creditors. If creditors' claims are satisfied by receiving equity in the reorganized company, existing stockholders will be **diluted** and possibly left with nothing.

Disclosure Obligations and Loss of Confidentiality

The debtor's finances become an open book on the filing of the bankruptcy petition. A complete **schedule** of assets and liabilities and a **statement of financial affairs** must be provided soon after the bankruptcy is filed (see Practice Note, Schedules and Statements of Financial Affairs: Overview). The debtor's officers and directors are subject to questioning about every aspect of the company's affairs. The debtor must comply with financial reporting requirements, such as monthly operating reports, and other administrative burdens (see Practice Note, US Trustee Guidelines and Requirements for Chapter 11 Debtors).

Stages of a Typical Freefall Chapter 11 Case

Each Chapter 11 case is unique and how it proceeds will depend on many factors, such as the size of the case and the debtor's industry (for example, asbestos and airlines, which have special concerns due to the nature of their assets). However, certain activities and processes are common to many traditional Chapter 11 cases. A typical Chapter 11 case normally proceeds in several stages which can be divided into six administrative stages and three business stages. These stages are not formal, and may overlap.

The administrative stages are:

- Case preparation (see Case Preparation).
- Case commencement (see Case Commencement).
- First days and weeks (see First Days and Weeks).
- Case administration (see Case Administration).
- Proposal and confirmation of plan of reorganization (see Proposal and Confirmation of Plan of Reorganization).
- Post-confirmation (see Post-Confirmation).

For a timeline of these stages, see Timeline of Chapter 11 Cases by Type.

The business stages are:

- Stabilization (see Stabilization).
- Development of business plan (see Development of Business Plan).
- Recapitalization/development of plan of reorganization (see Recapitalization/Development of Plan of Reorganization).

Administrative Stages

Case Preparation

The case preparation stage requires extensive amounts of paperwork, strategic planning, and analysis. This stage is also sometimes called the "contingency planning" stage, as it is a time when the debtor is considering alternatives to Chapter 11, such as an out-of-court restructuring or liquidation under Chapter 7 (see Out-of-Court Restructuring and Liquidation Alternatives Toolkit). The debtor may take a dual-track approach and simultaneously pursue another option while preparing the bankruptcy filing. Sometimes the company abandons its Chapter 11 preparations in favor of the other alternative.

Case preparation entails performing due diligence and gathering large volumes of information such as **financial statements** and material contracts to prepare the bankruptcy petition and its schedules and exhibits that must be filed on the first day, or shortly thereafter.

While this is occurring, it is important to implement confidentiality measures (until the case is filed) to avoid disruption to the business both internally (employees) and externally (vendors and customers). This involves discussing internally which employees will be aware of the bankruptcy preparations and what steps will be taken to ensure the confidentiality of those preparations. It may also include obtaining signed confidentiality agreements from third parties, such as banks, who are negotiating DIP financing.

One of the biggest tasks during this stage is preparing "first day" motions, which generally seek to minimize the disturbance caused by Chapter 11 (see Practice Note, First Day Motions: Overview and First Day Relief: Debtor Checklist). In some instances, first day motions request permission to override the statutory defaults and prohibitions of the Bankruptcy Code, such as the prohibition against paying any **prepetition** debts. First day motions fall into three categories:

- **Administrative.** Motions to establish procedures to relieve the debtor of unnecessary burdens (such as **joint administration** of related cases, additional time to file schedules, and applications to retain professionals).

- **Operational.** Motions to allow the debtor to operate with as few disruptions as possible (such as maintenance of current bank accounts, cash management procedures, request to continue to use existing business forms and checks, pay employees, and DIP financing).

- **Special.** Motions to permit the debtor to take advantage of unique bankruptcy powers (such as rejection of executory contracts and non-residential real estate leases) (see Powers, Protections, and Advantages of Chapter 11).

Cash planning is important during the case preparation stage. This includes obtaining DIP financing (see Practice Note, DIP Financing: Overview), negotiating **cash collateral** issues (see Practice Note, Cash Collateral: Overview), and cash planning generally.

Strategic planning is also crucial at this time. Determining where to file the case and which **subsidiaries** should be included in the filing involves strategic considerations:

- Deciding where to file takes into account:

    - the sophistication of the court;

    - which court is most likely to give a favorable outcome based on its established precedents; and

- (to some extent) the convenience of the court's location.

(See Practice Note, Venue in Bankruptcy Proceedings).

- Determining which subsidiaries should file involves a review of each subsidiary's financial condition and a strategic analysis of factors such as their contracts, leases, assets and liabilities, and the need to protect and preserve the assets of these entities by the automatic stay. It also involves a consideration of how closely dependent the subsidiaries are on one another such that it may not be appropriate to separate their financial and business operations for Chapter 11 purposes.

Finally, the debtor must assess and pay certain of its outstanding tax obligations to avoid exposing directors and officers to "responsible person" tax liability. Many federal, state, and local taxing authorities impose personal liability on certain directors and officers of entities that are responsible for collecting and paying certain taxes, such as use, sales, excise, employment, and **withholding taxes**. The automatic stay may not prohibit taxing authorities from attempting to collect outstanding taxes from responsible persons while the bankruptcy case is pending, so these taxes should be paid before the filing.

Case Commencement

This stage represents the first day of the case. The following key events and activities usually occur during this stage:

- The voluntary petition, along with exhibits and an affidavit of the debtor's representative in support of all first day motions, are filed with the bankruptcy court. A separate filing fee of approximately $1,700 for each debtor is required.
- The automatic stay is triggered immediately on the filing of the petition, preventing creditors from taking virtually any action to collect debts or exercise remedies against the debtor (see Practice Note, Automatic Stay: Overview: Prohibited Acts).
- All parties become subject to the rules of Chapter 11 of the Bankruptcy Code.
- First day motions are filed (see Case Preparation).
- The "first day hearing" is usually held on the first or second day of the case to present first day motions to the judge, who issues "first day orders" granting the requested relief. If first day orders are issued on an interim basis a "final" hearing is held within a few weeks (usually the case for DIP financing requests (see Timeline of DIP Financing Process)).
- A press release announcing the bankruptcy filing is issued and the debtor communicates with employees, customers, suppliers, and shareholders to alert them to the bankruptcy proceedings and the steps the company proposes to take in an effort to reduce their fears about how the bankruptcy proceedings will affect them personally.
- The prepetition books and records of the debtor are closed, except as otherwise permitted by order of the court. Further entries are stopped and new **postpetition** books and records are opened. For example, on the filing of the petition,

the debtor is technically required to close all existing bank accounts and open new accounts complying with certain investment guidelines.

First Days and Weeks

The first few days and weeks of the case are a flurry of activity for the debtor and its professionals. The following key events and activities usually occur during this stage:

- The **US Trustee**, who is appointed by the court to oversee the bankruptcy process (see Practice Note, US Trustee Guidelines and Requirements for Chapter 11 Debtors) appoints the creditors' committee. The creditors' committee represents the interests of unsecured creditors and ordinarily consists of the seven largest unsecured creditors willing to serve. For more information on creditors' committees, see Practice Note, Chapter 11 Creditors' Committees.

- The first joint meeting of company representatives and creditors (the **section 341 meeting**) must occur within 20 to 40 days after the filing of the bankruptcy petition. The US Trustee presides over the meeting, which provides creditors with an opportunity to examine the debtor under oath regarding its assets, liabilities, and intentions regarding reorganization.

- Certain bankruptcy schedules and statements must be filed with the petition or within 14 days thereafter, unless the court grants an extension (see Practice Note, Schedules and Statements of Financial Affairs: Overview). These documents include:

  - a list of creditors and **equity security holders**;

  - a statement of financial affairs;

  - a comprehensive schedule of all the debtor's executory contracts and unexpired leases; and

  - a schedule of assets and liabilities which lists debts on a creditor-by-creditor basis and assets in detail by specified categories.

- The debtor negotiates with creditors, particularly with prepetition bank lenders and with postpetition DIP financing lenders (who may be the same entities as the prepetition bank lenders, or may be new lenders) about issues such as the terms of the DIP financing (see Practice Note, DIP Financing: Overview).

- The debtor must comply with operating guidelines established by the US Trustee regarding:

  - employment and compensation of professionals (see Practice Notes, Getting Retained as a Professional to the Debtor-in-Possession and Getting Paid as a Professional to a Chapter 11 Debtor or Trustee); and

    - voluminous financial reporting requirements such as a verified monthly operating report which must include an operating statement, a balance sheet, and a summary of financial operations (see Practice Note, US Trustee Guidelines and Requirements for Chapter 11 Debtors).

- Certain notices must be prepared and served. Notices to creditors that the case had commenced are mailed individually to known creditors and published in national and regional newspapers. Letters are sent to banks and notices are sent to utilities informing them of the bankruptcy. Copies of first day orders are served on relevant parties, such as counterparties to executory contracts who are notified by service of the court order that the court has approved the rejection of their contract.

- The debtor must furnish its utilities with security deposits or other adequate assurance of payment (unless otherwise ordered by the court).

Case Administration

This is usually a relatively slower period of activity when the debtor's management can resume its focus on business operations. However, because of the operating restrictions imposed by the Bankruptcy Code (such as on the sale of material assets or the incurrence of additional debt), the debtor is continually consulting with its advisors. During this period, much time is spent negotiating (and maybe litigating) with **interested parties**. The following activities are typical in this stage:

- With the court's approval, the debtor assumes and rejects executory contracts and unexpired leases of nonresidential real property according to what it believes, in its business judgment, to be in the best interest of the debtors, creditors, and the **estate** (see Practice Note, Executory Contracts and Leases: Overview: Debtor's Options in Bankruptcy).

- The debtor negotiates with all creditors, and potentially litigates with some, over the various issues that arise during the case. For example, these may involve:

    - Defending against creditors' motions for relief from the automatic stay. For example, a creditor with a claim secured by a **mortgage** on the debtor's property may seek relief from the stay to **foreclose** (see Practice Note, Automatic Stay: Overview: Relief From the Stay).

    - Arguing about **adequate protection**. Adequate protection is a **secured party's** right to protection against the decrease in value of its collateral or other interest in the debtor's property. For example, if the secured party has a **security interest** in the debtor's car, it is entitled to adequate protection against the decline in value of the car while it is being used by the debtor during the bankruptcy (see Practice Note, Adequate Protection: Overview).

    - Disputing over the extension of various time periods to take specified actions under the Bankruptcy Code. For example, the debtor may request an extension of the statutory deadline to file the schedules to the bankruptcy petition.

    - Dealing with pressure from landlords and contract counterparties to assume or reject leases and executory contracts (see Practice Note, Executory Contracts and Leases: Overview: Debtor's Options in Bankruptcy).

- The debtor may sell certain material assets (which may be any asset, depending on the nature of the company), if it is in the best interest of the debtor, creditors, and the estate, if the sale is approved by the court (see Practice Note, Buying Assets in a Section 363 Bankruptcy Sale: Overview).

- The debtor must provide notice to creditors of the **bar date**, which is the deadline for filing **proofs of claim** (see Practice Note, Bar Dates in a Chapter 11 Bankruptcy Case). A proof of claim is an official form evidencing the validity and amount of the debt owed to the creditor (see Practice Note, Filing a Proof of Claim in a Chapter 11 Bankruptcy Case: What is a Proof of Claim?).

- The debtor reviews and objects to proofs of claim (see Practice Note, Filing a Proof of Claim in a Chapter 11 Bankruptcy Case: Some Common Grounds for Objections). Common objections are that the claim is:

    - duplicative;

    - untimely filed;

    - asserts the wrong **priority**;

    - valid but overstated; or

    - invalid under nonbankruptcy law.

- The debtor can recover prepetition transfers of property for the estate if it can prove a preference or fraudulent transfer (see Preferences and Fraudulent Transfers).

- The debtor must continue to file monthly operating reports and pay quarterly fees to the US Trustee for its services.

Proposal and Confirmation of Plan of Reorganization

At this stage, the debtor proposes a plan of reorganization and seeks to have it confirmed by the court. The following activities and key events usually occur during this stage:

- The debtor negotiates the terms of a plan with creditors. The plan is essentially a contract between the debtor and its creditors. It is generally flexible enough to accommodate whatever deal the parties agree to (see Practice Note, Chapter 11 Plan Process: Overview). Some common issues include classification of claims and the treatment or recovery that each class of claims receives under the plan (see Practice Note, Drafting Plans: Classification and Treatment of Claims and Interests).

- The debtor drafts the plan and its disclosure statement which, depending on the size and complexity of the case, can take anywhere from three months to several years (if there are several amended and restated plan proposals or competing plans) (see Practice Notes, Drafting Chapter 11 Plans: Overview and Chapter 11 Disclosure Statements: Overview). The disclosure statement describes the background of the case and the debtor's history, and explains the risk factors of the proposed restructuring plan to allow creditors to make an informed decision about the plan. During the first 120 days of the case the debtor has the exclusive right to propose a plan. This **exclusivity** period may be extended by the court to a maximum of 18 months after the petition date. After the exclusivity period expires, other parties may propose a plan.

- The court considers the disclosure statement at the disclosure statement hearing. The court will approve the disclosure statement if it contains "adequate information" sufficient for a voter to "make an informed judgment about the plan."

- After approval of the disclosure statement, it is circulated to voting creditors and equity security holders. The debtor has the first 180 days of the case to solicit the votes of impaired creditors and equity security holders. **Unimpaired** classes are presumed to have accepted the plan and their votes are not required. The solicitation period may be extended by the court to a maximum of 20 months after the petition date. Creditors and shareholders are divided into different classes for purposes of voting. Claims or interests may be grouped together in a particular class only if they are "substantially similar" in terms of quality or priority of legal rights (for example, all unsecured claims may be placed in the same class). An impaired class accepts the plan if two-thirds in amount and more than half the number of **allowed claims** voting in that class approves the plan. A plan may be imposed on an impaired class rejecting the plan if all of the cramdown requirements of the Bankruptcy Code are satisfied (see Non-Consenting Parties).

- The court considers the plan at the confirmation hearing, which generally occurs within a few months after the disclosure statement hearing to allow time for the required votes to be solicited and counted. The court will approve the plan if it makes specific findings, which include finding that the plan:
  - complies with applicable law;
  - was proposed in good faith;
  - is **feasible** (that is, confirmation is not likely to be followed by liquidation or the need for further financial reorganization) (see Practice Note, Feasibility Test: Confirmation of a Plan Under Section 1129(a)(11)); and
  - provides any dissenting parties with at least the value they would receive in a Chapter 7 liquidation (known as the "best interests of creditors" test) (see Practice Note, Liquidation Analysis: Best Interests of Creditors Test).

- The court enters a confirmation order approving the plan. The confirmed plan is binding on the debtor, creditors, and shareholders regardless of whether or not they accepted the plan or are impaired under its terms. The claims of all parties are satisfied as provided for in the plan.

For more information on the Chapter 11 plan process, see Practice Note, Chapter 11 Plan Process: Overview and Timeline of the Chapter 11 Plan Process.

Post-Confirmation

On confirmation of the plan, the debtor is **discharged** from both prepetition debts and postpetition pre-confirmation debts. The discharge does not necessarily terminate any liability for these debts, but rather is payable only under the terms of the plan. The debtor emerges as a new entity which operates its business as described in the plan. Confirmation of the plan vests all **property of the estate** in the debtor (see Practice Note, Property of the Estate: Overview). This means that the debtor regains control of its assets generally free and clear of all liens and security interests, unless the plan or confirmation order provides otherwise. The debtor may now operate without bankruptcy court supervision or any other restrictions that existed during the bankruptcy. The automatic stay is no longer in effect. For more information, see Practice Note, Chapter 11 Plan Process: Overview: Chapter 11 Discharge.

While business may return to normal for the debtor, confirmation of the plan of reorganization does not officially end the case. Some important activities and key events remain. The debtor must still consummate any transactions (or the "deal" between the parties) provided for in the plan. For example, the plan may provide that the debtor must obtain **exit financing** for ongoing operations after the bankruptcy or that it must secure funding to pay claims (see Practice Note, Exit Financing: Overview). The debtor must comply with the terms of the confirmed plan and any orders issued during the bankruptcy. While the details will vary in each case, the plan typically requires the debtor to distribute funds, **securities**, or property to holders of allowed claims and interests after confirmation. For more information, see Practice Note, Chapter 11 Plan Process: Overview: Implementation of a Plan.

The case may continue for several more months or years, depending on its size and complexity, as well as the availability of the court. During this time, the debtor may be resolving claims that were not resolved before confirmation or continuing to litigate **adversary proceedings** regarding matters such as the use, sale, and lease of unencumbered property, adequate protection, and the assumption or rejection of executory contracts and unexpired leases. At times, the court may even have to rule on disputes regarding implementation or interpretation of the plan.

When the court enters a final decree, the case will be officially closed and the company will be out of bankruptcy. The case need not be left open until the plan is fully consummated, as most plans provide that the case can be reopened for cause shown (see Practice Note, Closing and Reopening a Chapter 11 Case). The company must continue to pay US Trustee fees for its services until the case is closed, dismissed, or converted to another chapter (see Practice Note, US Trustee Guidelines and Requirements for Chapter 11 Debtors: US Trustee Quarterly Fees) . If the plan cannot be implemented and a default occurs, the reorganized debtor has several options including:

- Attempting to cure the default.
- Converting the case to a Chapter 7 liquidation (see Bankruptcy Conversion Tookit).
- Commencing a new bankruptcy case to reorganize or liquidate.
- Modifying the existing plan (see Practice Note, Drafting Chapter 11 Plans: Overview: Post-Confirmation Plan Modifications).

Business Stages

Stabilization

The Chapter 11 filing causes a major disruption to the debtor's business operations, particularly during the first few days and weeks of the case. During this period, the debtor focuses on reversing the adverse impact of the filing. Typically the debtor fields inquiries from customers, suppliers, employees, creditors, investors, and sometimes even the media. To stabilize the business, the debtor must boost employee morale and regain the confidence of its customers and suppliers.

Development of Business Plan

In this stage, the debtor focuses on developing a long-term business plan. Gaining creditor support for that plan is crucial to the debtor's success. To do so, the debtor must keep its creditor constituencies fully informed of its progress in developing a viable business strategy. This will involve justifying its **financial projections** and explaining exactly how these projections can be attained.

Recapitalization/Development of Plan of Reorganization

At this point, the debtor proposes a modified capital structure which reflects the actual ability of the business to service debt. The restructured balance sheet must be consistent with what the business plan can support. Once consensus is reached with creditors on the proposed structure, the parties negotiate to develop a plan of reorganization that implements their restructuring agreement.

ABI Commission to Study the Reform of Chapter 11

After undertaking an in-depth three-year study, on December 8, 2014, the ABI Commission to Study the Reform of Chapter 11 (Commission) proposed significant changes to Chapter 11 of the Bankruptcy Code and issued its Final Report and Recommendations (Report).

While the Report's proposals have not yet resulted in legislation, certain bankruptcy participants have used many of the Report's proposals to influence courts, some of which have been receptive to these arguments. Proposed reforms that address current circuit splits may be incorporated into case law, as judges may be swayed to decide splits of authority in line with the applicable proposal (see Practice Note, Bankruptcy: Splits of Authority Among Circuit, District, and Bankruptcy Courts Tracker). In many cases, the recommendations also reflect what is already current market practice.

For more information, see Article, ABI Commission Report on Chapter 11 Reform: Selected Proposals Affecting Secured Creditors and Distressed Investors.

For Further Reading

Norton Bankruptcy Law and Practice, 3d. is the leading treatises on bankruptcy law, which provides extensive overviews and commentary of the Bankruptcy Code.