

A Short Course on Bankruptcy

Professor Gregory Germain
Syracuse University College of Law

State Law Collection Process

- Corporation: Limited Liability Entity
- Unsecured Creditors of Corporation
 - File Lawsuit
 - Get Judgment
 - Locate Corporate Assets
 - Personal Property: Have Sheriff execute and sell
 - Real Property: Judgment Lien
 - Race to the Courthouse – Survival of the fittest

Secured Creditors

- Creating a Security Interest in Personal Property
 - **Attachment: creates a lien**
 - (1) Security agreement,
 - (2) Creditor gives value,
 - (3) Debtor has rights in collateral

Secured Creditors: Personal Property

- **Perfection: Attachment + UCC-1 financing statement**
 - Recorded with Secretary of State generally where the debtor is incorporated
- **Priority: Between 2 creditors, who gets paid in what order from the collateral**
 - General rule: **first to file or perfect**

Personal Property Example

- A applies for loans from Bank1 and Bank2.
- Bank 1 files UCC-1 financing statement, then Bank 2 files a UCC-1.
- A takes out **\$100,000 loan from Bank2. No loan from Bank1.**
 - A signs promissory note, security agreement covering equipment, UCC-1 financing statement with **Bank 2.**
- **1 year later**, A borrows **\$50,000 from Bank1.**
 - Signs promissory note and security agreement. Bank 1 already has UCC-1 financing statement on file.
- Question:
 - Which lien **ATTACHED** first?
 - Which lien was **PERFECTED** first?
 - Which lien has **PRIORITY**?
- Suppose property worth \$90,000 and borrower defaults. Who gets money?
 - Bank1 gets \$50,000. Bank2 gets \$40,000 (\$60,000 deficiency).
- What should Bank 2 have done?

Secured Creditors – Real Property

- **Consensual liens on real property**
 - **Mortgage or Deed of Trust.** Recorded in County where the real estate is located
- **Right of Redemption: pay full debt and get property back free of lien**
 - Distinguish **redemption** and **cure**
- **Foreclosure of Right of Redemption**
 - **Personal Property:**
 - Recovery collateral: Self Help w/o breach of peace, Replevin
 - Foreclosure Sale: “commercially reasonable”
 - **Real Property:** Foreclosure Sale (most states judicial)

Discharging Liability

- You buy a house for \$100,000.
 - \$20,000 Down
 - \$80,000 Mortgage
- You sell house to Professor Diz for \$100,000
 - Professor Diz pays you \$20,000 Cash
 - Professor Diz **assumes** \$80,000 Loan
- Professor Diz defaults.
- Bank forecloses and sells for \$60,000. Owed \$80,000. What happens?
 - \$20,000 deficiency. Unsecured claim.
- Can bank come after **you** or only Professor Diz who **assumed** loan?

Bill Gates Hypo

- Bill Gates worth 87.5 BILLION
- **\$87,500,000,000.00**
- Goes to bank and borrows \$1 million. Signs promissory note
- Goes to Armory Square. Gives bottle of ripple to guy sleeping on park bench if he will “assume” the loan.
- Says to bank “collect from the guy in Armory Square.” Does this work?
- Assignment =/ Absolution.
- Only 2 ways go get out of liability
 - (1) get **release** from creditor
 - (2) get bankruptcy discharge

Question 1: Workout

- Bonds and Debentures: **Trust Indenture Act**
 - Cannot change terms of payment without consent of EACH bondholder
 - Other “non-core” terms can be changed with specified majority votes
- **Question 1:**
 - Covenants in indenture prevents corporation from granting liens on collateral (**negative pledge**).
 - Indenture provides that covenants can be **waived with votes of 70%** of bondholders
 - Corp insolvent and bonds selling on market for 50% face
 - **Exchange offer:**
 - New bond at 65% of face of old bonds IF at least 70% of bondholders agree.
 - If wish to tender, must agree to waiver of covenants. **“Exit consents.”**
- **Strategy:**
 - If don’t exchange and 70% do, lose covenants and bonds may be worth very little.
 - If exchange, get premium over market but much less than face.
 - Is **coercive** exchange legal?
 - *Katz v. Oak Industries*, 508 A.2d 873 (Del.Ch. 1986).

Summary of State Law

- Unsecured creditors: **Race to the courthouse.**
First to get judicial lien gets paid before later unsecured creditors
- Secured creditors: first to **“file or perfect”** rule
- **State law workouts**
 - Need consent of EVERY CREDITOR, but can coerce consents if have some contractual leverage
 - Without leverage, **holdout problem**

Principles of Bankruptcy

- **Equality of Distribution:** The Absolute Priority Rule
- **Organized Sale:** Get highest value rather than fire sale foreclosure
- **Disclosure:** Debtor must publicly disclose assets, liabilities, income, expenses. Subject to judicial administrative scrutiny
- Method for addressing **holdout problem** with special majority voting rules
- Power to **Discharge** Debts
- Fundamental Requirement for Reorganization: **Best Interests of Creditors**
 - All nonconsenting Creditors **better off** than in liquidation

Organization of Bankruptcy Code

- Chapters 1, 3, 5: General rules
- Chapter Proceedings:**
 - Chapter 7: Liquidation
 - Chapter 9: Municipalities
 - Chapter 11: Custom business reorganizations
 - Chapter 12: Family farmers/fisherman
 - Chapter 13: Wage earner reorganizations
 - Chapter 15: Transnational

Chapter 7 Eligibility

- Individuals/Businesses, except regulated industries (banks, insurance companies)
- **Voluntary** petitions: filed by eligible debtor
- **Involuntary** petitions: Debtor “**generally not paying debts when due.**”
 - Usually, 3 creditors must join together to file petition
 - If petitioning creditor loses, must pay debtor’s costs; punitive damages if “willful”

Year Ending March 2014

Bankruptcy Filing Statistics		
	Total Filings	%
Chapter 7	699,982	67%
Chapter 11	8,564	1%
Chapter 13	329,256	32%
Other	478	0%
Total	1,038,280	100%
Business Filings	31,671	3%
Percent of Households	0.90%	

The Bankruptcy Estate

- Everything the debtor owns on filing date
 - **Exemptions** for individual debtors
- Growth of Property: “proceeds, products, offspring, rents or profits”
- What’s not in the estate?
 - **Individual debtor post-bankruptcy earnings**
 - Property held for another - trusts
- Corporation has **no future** separate from the bankruptcy estate

Secured and Unsecured Claims

- **502: Creditors file proof of claim** – deemed allowed **unless objection**.
- **Unsecured claims:** Any right to payment: Unliquidated, unmatured, disputed, contingent
- **Secured claims** – lien on debtor’s **property**
 - Mortgages, Security Interests
 - Judicial Liens

Personal Property Example

- Corp **borrowed \$500,000** from Bank A secured by equipment. Interest only for 5 years
- Corp signed
 - Promissory Note
 - Security agreement
- Bank A filed Financing Statement (UCC-1)
- Corp owed **\$50,000** in **prepetition** interest on date of bankruptcy, and **\$30,000** in **post-petition** interest has accrued since bankruptcy
- What are Bank's claim(s) in bankruptcy?

Claims in Bankruptcy

- **Unsecured claims** – Sec 502
 - Claims determined **as of petition date**.
 - No **post-petition** interest.
 - Unliquidated/contingent claims estimated if objection filed
- **Secured claims**
 - **Unperfected** secured claims become unsecured. Sec. 544(a) strong arm power.
 - **506(a) Split**: Secured to **value of collateral**, unsecured deficiency.
 - Need to know the value of the collateral!
 - **506(b) Post-Petition** Interest, fees, costs and charges: Only **oversecured** creditor

Hypo: Undersecured Creditor

- Under loan docs, Bank is owed
 - \$500,000 principal
 - \$50,000 **prepetition** interest
 - **\$30,000 post-petition interest**
- Collateral worth **\$300,000**
- What claims does the bank have in bankruptcy?
 - **Secured claim:** \$300,000
 - **Unsecured Claim:** \$250,000
 - No **post-petition interest**, fees, costs or charges.

Hypo – 506(a) split - **Oversecured**

- Under loan docs, Bank owed
 - \$500,000 principal,
 - \$50,000 prepetition interest,
 - \$30,000 post-petition interest
- Collateral worth **\$700,000?**
 - **Secured claim** of \$580,000
 - **Unsecured Claim** of \$0
 - Entitled to post-petition interest, fees, costs, charges
- What if equipment worth **\$560,000?**
 - **Secured claim:** \$560
 - **Unsecured claim:** 0
 - Interest stops accruing when no more equity cushion

Question 2 [p. 12]

- **Tablets-R-US, Inc. (“TRU”)**
 - New York corporation
 - Manufactures Android computer tablets.
- **EasyLoan: \$1 million + \$25,000 prepetition interest**
 - Promissory note (10% interest year)
 - Security agreement - inventory.
- **Inventory value: \$650,000.**
- **Question 1:** What claims will EasyLoan have in TRU’s bankruptcy proceeding?
 - Secured: \$650,000
 - Unsecured: \$375,000
- **Question 2:** Can EasyLoan recover post-petition interest?
 - No

Unsecured claims

- **Claim limitations**
 - Unmatured interest
 - Prospective employment contracts (1 year future wages)
 - Prospective rent under real property leases (1-3 years future rent)
- **Bankruptcy priorities:**
 - Administrative claims
 - Professionals
 - Anyone providing post-petition credit
 - Tax claims (w/l 3-4 years, withholding)
 - Recent unpaid wages (+- \$12,000 per employee)
- **Subordination agreements**
 - What are they?
 - Why would someone sign one?

Distribution

- **Absolute Priority Rule:** Entitlement to payment
 - (1) Secured claims paid first **from collateral.**
 - Deficiencies are unsecured
 - (2) **Priority** unsecured claims in order listed in Bankruptcy Code
 - Administrative priority
 - Wage Priority
 - Tax Priority
 - (3) **General unsecured** claims
 - Determined as of petition date – no interest
 - (4) **Subordinated** claims per agreement (or equitable subordination). Can have multiple classes of subordinated claims
 - (5) **Post-petition interest** on all unsecured claims at legal rate (not contract rate)
 - (6) **Debtor** (subject to liquidation preferences – preferred stock, etc)

Operating the Ch 7 estate

- Trustee's job:
 - Liquidate property of the estate
 - May operate to sell as going concern, or break up. Get best price
 - Section 363: Can “use, sell or lease property of the estate”
 - Cash Collateral limits
 - Non-Ordinary Course: need court approval on notice

The Automatic Stay

- Any post-petition acts to try to collect a claim from the debtor or estate
- **Relief from stay** – generally by secured creditor to recover collateral (page 13)
 - “Cause” including not **adequately protected**, **OR**
 - (1) No Equity + (2) Not necessary for effective reorg
- **Supreme Court in *United Savings v. Timbers*:**
 - **Adequate protection**: Secured creditor must be harmed from post-request decline in **value** of collateral.
 - **Necessary for effective reorganization**
 - Reorganization must be “in prospect”
 - Debtor must show that it **can reorganize** within a reasonable period of time – not just that it would need property if it were able to reorganize
 - Reasonable time: Generally 4 mos – 1 year

Questions 3

- **Reconsider Question 2:**
- Facts **Undersecured** creditor. 506(a) Split:
 - \$650K secured,
 - \$375K unsecured
- **Question 3:**
 - What must EasyBank show to get relief from stay?
 - What must debtor show to prevent relief from stay?

Question 4 [15]

- Assume the facts in Question 2 (Easybank \$650 secured, \$375 unsecured)
- Other Assets:
 - Equipment (Book Value \$4 million, Liquidation Value \$1 million)
 - Factory building (Book Value \$2 million, Liquidation Value \$2.5 Million)
- Other Liabilities
 - Unsecured trade creditors: \$800,000
 - Senior debenture holders: \$1.2 million
 - Junior subordinated debenture holders: \$6 million.
- Stockholder investments: \$3 million.
- Bankruptcy value: Business as a whole (going concern) worth \$5 million (including TRU's Collateral).

Question 4

How much outside of bankruptcy

- Organize facts
 - What happens to assets outside of bankruptcy?
 - Secured creditors foreclose.
 - If liquidation value > secured claims, excess will go to levying creditors.
 - Organize liabilities by priority

Question 4: State Law Liquidation of Tablets-R-U's		
Assets		
Liquidation Value of Assets		\$ 3,500,000.00
Unsecured Claims	Amount	
EasyBank unsecured claim	\$ 375,000.00	
Trade creditors	\$ 800,000.00	
Senior debentures	<u>\$ 1,200,000.00</u>	\$ 1,125,000.00
Subordinated debentures	\$ 6,000,000.00	18.75%
Who would get the money if there wasn't enough to pay the unsecureds in full?		

Question 4

How much in Chapter 7

- Organize facts
 - Value of assets in orderly sale – going concern
 - Organize liabilities by priority
 - Assume priority administrative expenses of \$50,000 for Trustee.

Question 4: Bankruptcy Sale		
Assets		
Sale as going concern		\$ 5,000,000.00
Liabilities		
	Amount	Remaining
EasyBank Secured claim	\$ 650,000.00	\$ 4,350,000.00
Administrative expenses	\$ 50,000.00	\$ 4,300,000.00
Trade Creditors	\$ 800,000.00	
EasyBank unsecured claim	\$ 375,000.00	
Senior debentures	<u>\$ 1,200,000.00</u>	\$ 1,925,000.00
Junior debentures	\$ 6,000,000.00	32.08%

Alternatives to Bankruptcy

- Workout:
 - Debtor does not have enough money to make the upcoming payment to the subordinated debenture holders.
 - If they sue, everyone will declare default, sue, and levy
 - Can debtor offer more to creditors over time than they would get in liquidation?
- Two problems
 - Can the business be operated profitably after getting concessions from creditors?
 - Structural problem: Cannot change payment terms unless all bondholders agree (Trust Indenture Act)

Question 5: Exchange Offer

- Subordinated Debts 30% haircut: \$1,000 subordinated debenture will be offered a \$700 bond secured by TRU's equipment and building
- Value of \$700 **secured** bond much higher than \$1,000 **unsecured** subordinated deb
 - Note: \$1,000 unsecured bond worth only \$187.50 in a state court liquidation or \$320.80 in Chapter 7
 - \$700 secured bond worth \$700 in bankruptcy
- How do you get all subordinated debts to exchange?
- What is the capital structure of the corporation after the exchange offer?

Question 5: State Law Liquidation of Tablets-R-U's		
Assets		
Liquidation Value of Assets		\$ 3,500,000.00
Sub Deb secured claim		\$ (3,500,000.00)
Value for Unsecureds		\$ -
Unsecured Claims		Amount
EasyBank unsecured claim	\$	375,000.00
New sub deb unsecured claim	\$	700,000.00
Trade creditors	\$	800,000.00
Senior debentures	\$	<u>1,200,000.00</u>
Total Unsecureds	\$	3,075,000.00
Distribution to unsecureds	zero	

Question 5: Bankruptcy Sale		
Assets		
Sale as going concern		\$ 5,000,000.00
Liabilities		
	Amount	Remaining
Secured claims		
EasyBank Secured claim	\$ 650,000.00	\$ 4,350,000.00
Jr Deb Secured Claim	\$ 3,500,000.00	\$ 850,000.00
Priority Claims		
Administrative expenses	\$ 50,000.00	\$ 800,000.00
Unsecured Claims		
EasyBank unsecured claim	\$ 375,000.00	
Trade Creditors	\$ 800,000.00	
Former Jr deb unsecureds	\$ 700,000.00	
Senior debentures	\$ 1,200,000.00	
Total Unsecureds	\$ 3,075,000.00	26%

Enhancing the Bankruptcy Estate

- **Strong arm power**
- **Fraudulent conveyances:** transferring property or incurring debt
 - with **actual intent** to defraud creditors, or
 - No **REV** + insolvent
 - REV includes payment or securing of antecedent debt
- **Preferences:** Pmts to creditors w/l 90 days
 - Lots of exceptions: Ordinary course, new value, de minimis, late perfection

Question 6 [18]

- Unsecured loan 2 years ago
- Demands a mortgage on borrower's house
- Mortgage recorded day before bankruptcy
 - Strong arm clause?
 - Fraudulent conveyance?
 - Preference?
- What if mortgage recorded the day after bankruptcy

Question 7 [18]

- Debtor going out of business
- Owes \$50,000 to creditors.
- Before filing bankruptcy, donates last \$10,000 to the Salvation Army rather than see it go to pay creditors.
- Is the transfer avoidable?
 - Strong Arm
 - Preference
 - Fraudulent conveyance?

Question 8 [18]

- Can the exchange in Question 5 be avoided under
 - (a) the strong arm power,
 - (b) the fraudulent conveyance power, or
 - (c) the preference power?
- Preference?
 - Exchange 80 days ago (within 90 day period if file NOW)
 - Do Subordinated Debs get more than if they didn't do the exchange?
 - **BK after exchange:** 3.5m + 26% of \$700k = \$3,682,000
 - **BK before exchange:** 32% of \$6 mil = \$1,920,000
- What should trade creditors do?
 - File involuntary before 90 day period expires!

Is this Realistic?

- Consider terms of indenture for forcing exchange
 - May prohibit preferential exchanges
 - May require unanimous consent to amend covenants (negative pledge)
 - May require ratable protection for secured claims

The Discharge

- Chapter 7: General order discharging all dischargeable debts.
 - Does not discharge **liens**
- Plans: Order discharges all debts not provided for in the plan

CHAPTER 11

Chapter 11 Players

- Debtor
- **Debtor in possession: Sec. 1107**
- Creditors' committee
- Trustee
- Examiner

Plan Process

- **Exclusivity:** 120/180 days/ 18/20 months
- **Disclosure Statement – “adequate information”**
 - Court approval or pre-pack process.
 - Classification - Claims must be “**substantially similar**”
 - Secured claims must be separate from unsecureds and from each other, unless secured by the **same property** and **same priority** (bonds)
 - Unsecureds generally in same class unless
 - Different priority (subordination)
 - **Grounds for separate classification:** (1) different voting motive, or (2) “good business reason” other than gerrymandering votes.

The Voting Process Class Acceptance

- **Creditors**
 - At least $\frac{2}{3}$ in amount, **AND**
 - More than $\frac{1}{2}$ in number
- **Equity security holders**
 - At least $\frac{2}{3}$ in amount.
- **Only voters count** in numerator and denominator

Question 9

Which classes have accepted and rejected the plan?

	Class 1	Class 2	Class 3	Class 4	Class 5
Number					
Yes	6	90	51	1	0
No	6	30	50	0	1
Abstain	6	60	90	0	0
Amount					
Yes	\$ 500,000	\$ 490,000	\$ 720,000	\$ 50,000	\$ -
No	\$ 250,000	\$ 250,000	\$ 250,000	\$ -	\$ 25
Abstain	\$ 500,000	\$ 500,000	\$ 100,000	\$ -	\$ -

	Class 1	Class 2	Class 3	Class 4	Class 5
Number					
Yes	6	90	51	1	0
No	6	30	50	0	1
Abstain	6	60	90	0	0
Amount					
Yes	\$ 500,000	\$ 490,000	\$ 720,000	\$ 50,000	\$ -
No	\$ 250,000	\$ 250,000	\$ 250,000	\$ -	\$ 25
Abstain	\$ 500,000	\$ 500,000	\$ 100,000	\$ -	\$ -
Number	50.00%	75.00%	50.50%	100.00%	0.00%
Amount	66.67%	66.22%	74.23%	100.00%	0.00%
More than half in number?	No	Yes	Yes	Yes	No
At least 2/3 in amount?	Yes	No	Yes	Yes	No
Accept?	No	No	Yes	Yes	No

Impairment

- **Cannot change “legal, equitable or contractual rights”**
- Except: can **cure** default and reinstate original term of loan
- **Deemed Acceptance and Rejection**
 - **Unimpaired** class deemed to **accept**
 - Class that receives **no distribution** deemed to **reject**

Questions

- Are the following classes impaired?
 - (1) Class 1 will be **paid in full** on the effective date of the plan.
 - (2) Class 1 will be paid in full one day after the effective date of the plan.
 - (3) The Class 1 creditor will be given its collateral in full satisfaction of its claims.
 - (4) The Class 1 creditor will be paid all missed payments on the effective date of the plan, and will thereafter receive monthly payments in accordance with the terms of the loan documents.
 - (5) The Class 1 creditor's claim will be paid in full with interest in monthly installments of \$125,000.

Confirmation Requirements

- **Best interests test** – each creditor who votes against the plan, **not each class**, will receive property of a **value as of the effective date** (PV) \geq amount creditor would receive in Chapter 7
 - How do we prove this?
 - Perform **hypothetical liquidation test**. If we liquidated all assets in Ch 7, how much would each creditor in each class get. Are they getting more in PV under plan?
- **One impaired class must accept** – this is why classification is important
- **The plan is “Feasible”**
- + **either**
 - **All classes accept**, or
 - **CRAMDOWN** on non-accepting classes

Section 1111(b)

1111(b) (1) (A): A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same **as if the holder of such claim had recourse** against the debtor on account of such claim, whether or not such holder has such recourse, unless [elects under (b)(2)].

1111(b)(2): If such an election is made, then **notwithstanding section 506 (a)** of this title, such claim is **a secured claim to the extent that such claim is allowed.**

- **Example:** \$10 million non-recourse debt secured by \$6 million of assets
 - No election: \$6 mil Secured, \$4 mil Unsecured
 - Election: \$10 mil Secured no Unsecured (but property still only worth \$6 million)

Secured Creditor Cramdown

1129(b)(2)(A). With respect to a class of secured claims, the plan provides—

- (i)(I) that the holders of such claims **retain the liens** securing such claims **to the extent of the allowed amount** of such claims; and
 - *What happens under 506(a) or 1111(b)(2) in our example (\$10M debt, \$6M value of collateral)?*
- (II) that each holder of a claim of such class receive on account of such claim **deferred cash payments totaling** at least the **allowed amount** of such claim, **of a value**, as of the effective date of the plan, of at least the **value of such holder's interest in the estate's interest in such property**;
 - What is difference between payments “**totaling**” allowed amount and having a “**value as of effective date**” equal to value of interest in property?
 - *How much does the debtor have to pay on the secured claim if the creditor makes or does not make the 1111(b)(2) election?*

Interest Rate/Discount Rate Till v. SCS Credit (Supreme Ct)

- Formula approach: “Prime” plus Risk Factor
 - What is prime rate?
 - Till majority said risk factor generally 1-3% over prime.
 - Creditor can show higher, debtor can show lower.
 - Most courts have adopted 2% over prime to preserve value as of effective date
 - Note: 506(b): only **over-secured creditors** get interest
 - Three separate periods: Prepetition, Post Petition Pre Confirmation, **Post Confirmation**

Question 10 [29]

- BigBank \$**12 million claim** secured by \$**9 million** property.
- Interest rate to preserve PV under Till is **10%**
- The Court will not permit the plan term to exceed **20 years**.
- Bankruptcy Code requires equal monthly payments over the term.
- Calculate a monthly payment that will allow the Debtor to confirm the plan over BigBank’s objection if it makes the 1111(b)(2) election, and will also minimize the debtor’s interest expense.

Secured Claim	\$ 12,000,000
Collateral Value	\$ 9,000,000
Interest Rate	10%
Term (Months)	240
Payment	\$ 86,852
PV of Pmts	\$ 9,000,005
Total Pmts	\$ 20,844,480

Unsecured Creditor Cramdown

1129(b)(2)(B): With respect to a class of unsecured claims—

- (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a **value, as of the effective date of the plan, equal to the allowed amount** of such claim; or
- (ii) the holder of **any claim or interest that is junior** to the claims of such class **will not receive or retain under the plan on account of such junior claim or interest any property**

New Value Exception?

“the holder of **any claim or interest that is junior** to the claims of such class **will not receive or retain under the plan on account of such junior claim or interest any property**”

Questions:

1. What happens to the stockholders under our plan?
2. What if we provide that the stockholders will buy their stock for a new contribution of money?

BofA v. 203 N. LaSalle

- Limited Partnership
- Bank has \$54 million secured claim
- Property worth only \$16 million (\$38.5m unsecured claim)
- Plan:
 - Pay \$16 million secured claim in full over plan term
 - Unsecured creditors: \$90,000 + \$38.5m deficiency claim.
 - No way to get acceptance because bank wants to foreclose
 - Plan: Pay 16% to unsecureds. Partners contribute \$6.125m (new value) in return for keeping equity.
 - Argue not keeping equity on account of prior shareholder interest, but on account of new value.
- **Held:** violates absolute priority rule because may not be highest bidder for equity – exclusive right to buy equity is interest in property received on account of old partnership interests.
- Therefore, if there is a new value exception, old equity must be high bidder – open bidding process.

Old Equity in Confirmation

- **Consent:** Unsecured classes vote to give distribution to equity
- **Full Payment:** Pay unsecureds in full with interest over time.
- **New Value:** Maybe new value with old equity as highest bidder.
- **Wipe Out Old Equity.** Give new equity to unsecureds and wipe out old equity

Hot Topics

- 363 Sales of the entire business right after filing
 - General Motors, Chrysler, Lehman Brothers
- Structure
 - Transfer assets to new entity in return for some stock in new entity
 - Remaining stock goes to new investors, workers, favored unsecured creditors (this accomplishes reorganization)
 - Liquidation plan – distribute new stock to old creditors and terminate
 - Problem: Undermines the entire Chapter 11 process:
 - No plan and disclosure statement
 - No voting or say by creditors
 - Priority for workers/favored creditors violates absolute priority rule
 - Historical Test: **LIONEL:** Perishability – sound business reason to sell now rather than under plan. Business will die if we don't sell now.

Question 11 [32]

- TRU to sell all of its assets to NewCorp, a newly-created corporation, in return for (1) a \$3,975,000 million promissory note, and (2) the assumption of secured loans.
- NewCorp is wholly owned by the existing stockholders of TRU who promise to contribute money to meet the obligations under the promissory note in return for stock.
- Court determines that \$3,975,000 plus assumption of secured claims is a fair price for TRU's assets.
- TRU and NewCorp argue that TRU will go out of business unless there is an immediate sale because there is no financing available to pay workers and operating expenses.
- Questions:
 - Should the Court allow the sale?
 - Would a plan to accomplish the same objective be confirmable over the objection of the other unsecured creditors?
 - Should the sale be approved at the beginning of the case without complying with the solicitation and voting processes of Chapter 11?

Fernando Intrinsic value