

Chapter 11 Reorganization Process

Chicago/Midwest TMA Nuts and Bolts Program
October 14, 2010



Agenda

Introductions

Purpose and Benefits of Chapter 11

Overview of Chapter 11 Process

Preparing for a Filing and Filing

Core Proceeding

Preparing for Confirmation and Confirmation

Post-Confirmation

Panelist Introductions

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Purpose and Benefit of Chapter 11



Reorganization Objectives

A BALANCE BETWEEN THE CONFLICTING CONCEPTS OF:

**Providing a
“fresh start”
or rehabilitation
for Debtor**

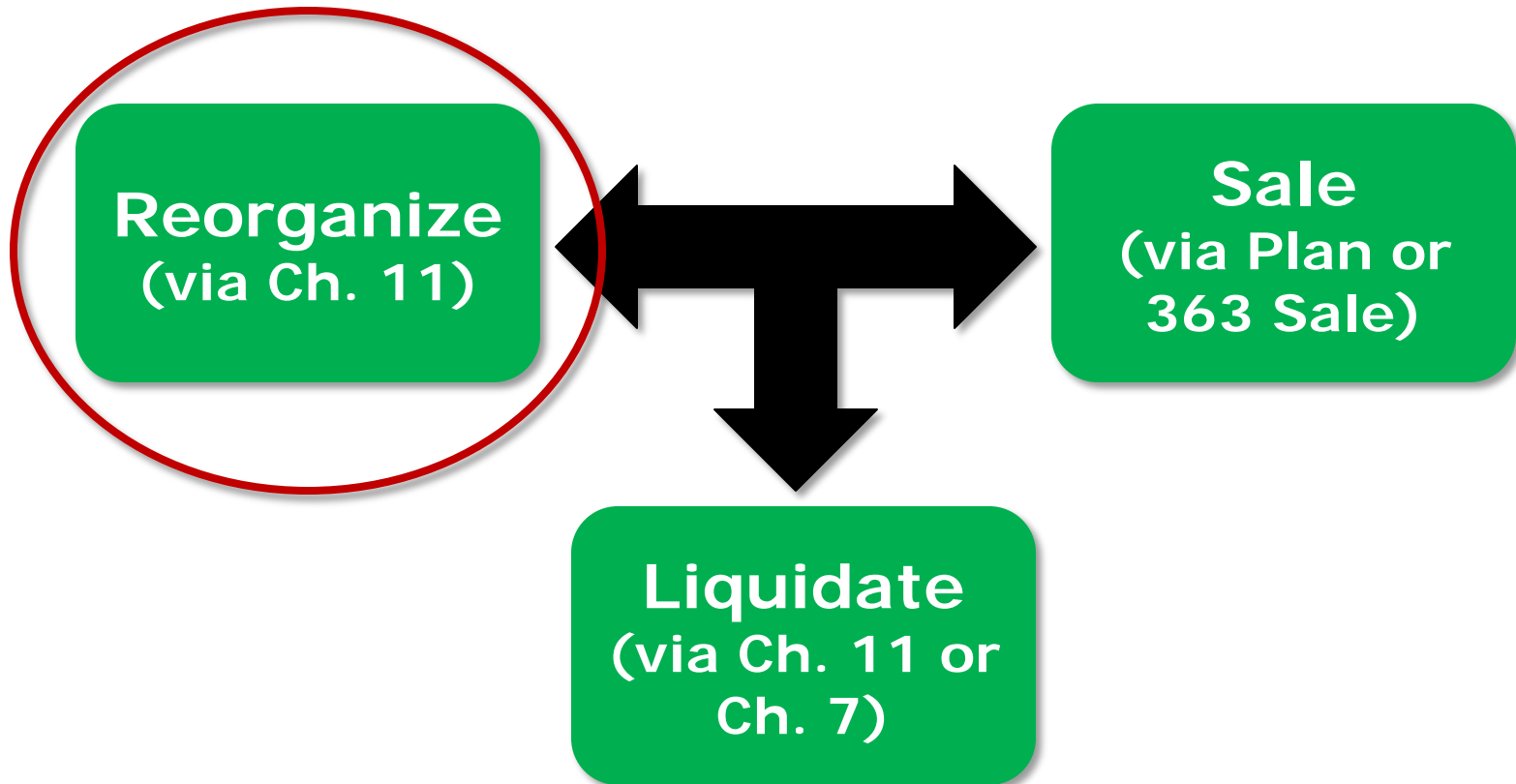


**Protecting
Creditors' rights
to receive payment**

***While fairly distributing the value of the Debtor's
Estate amongst competing Creditors***

Bankruptcy Alternatives

An insolvent Debtor has three primary alternatives to satisfy its Creditors



The Basics

- Bankruptcy Code (11 U.S.C. §101, et seq.) governs bankruptcies in the U.S.
- Bankruptcy Code Chapters applicable to businesses
 - Chapter 11: Allows for reorganization of business and capital structure while continuing "normal" operations
 - Chapter 7: Assets are liquidated by trustee
 - Chapter 15: Ancillary insolvency proceeding in U.S. to a primary proceeding in another country
- In Chapter 11, management and Board continue to control businesses and properties
 - Added oversight from Court and various constituencies
- In Chapter 7, management and Board replaced by trustee
 - High creditor threshold to convert to Chapter 7

Automatic Stay (§362)

- The "automatic stay" prevents a creditor from commencing or continuing collection suits or other actions against the debtor and from enforcing judgments obtained prior to the filing of the petition that would affect property of the estate of the debtor
- Prevents others from taking any action adverse to debtor's estate based upon a prepetition obligation
 - Stops continuation of all pending litigation
 - Prevents new suits from being filed
- A creditor can petition the Bankruptcy Court to have the automatic stay lifted
 - Cause, including lack of adequate protection
 - Lack of equity in property subject to a security interest and the property also must be unnecessary for an effective reorganization
 - Most often sought by secured creditors

In-Court v. Out-of-Court Factors

	Out-of-Court	In-Court
Capital Structure	Simple, Few Tranches	Complex, Multiple Tranches
Securities	Privately Held	Publicly Held
Second Lien Debt	No	Yes
Bond Indentures	Unrestrictive voting requirements	Restrictive voting requirements
Unsecured Creditors	Few, Unsophisticated	Many, Sophisticated
Vendors	Few and/or Not Critical	Many and/or Critical
Customers	Consumers	Sophisticated
Leases, Executory Contracts and CBAs	Unimportant and/or At Market	Need to Restructure or Reject
Pension Plans	Funded or Defined Contribution	Underfunded
Litigation Claims	No	Yes
Size	Smaller	Larger
Valuation	Agreement Amongst Parties	Fulcrum Security Uncertain
Liquidity	Sufficient Liquidity, Unencumbered Collateral	Limited Liquidity, No Unencumbered Collateral

Kinds of Chapter 11 Cases

Pre-packaged

Pre-negotiated

Conventional

Liquidating

Major Reasons
Motivating the Filing

Loss of Liquidity

Balance Sheet
De-leveraging

Mitigation of
Contingent Liabilities

Strategic Operating
Restructuring

Transactional

Strategic

Kinds of Chapter 11 Cases (cont.)

- Pre-packaged cases
 - Expedited trip through Chapter 11
 - Petition filed accompanied by complete disclosure statement and plan
 - Votes solicited in advance of filing and court retroactively approves solicitation
 - Expedited hearing to consider adequacy of disclosure statement and confirmation
 - Generally limited numbers of classes entitled to vote
- Pre-negotiated or pre-arranged cases
 - Plan support agreement / term sheet
 - Vary widely in degree of prenegotiation and prefiling commitment
 - More feasible when few constituencies negatively impacted

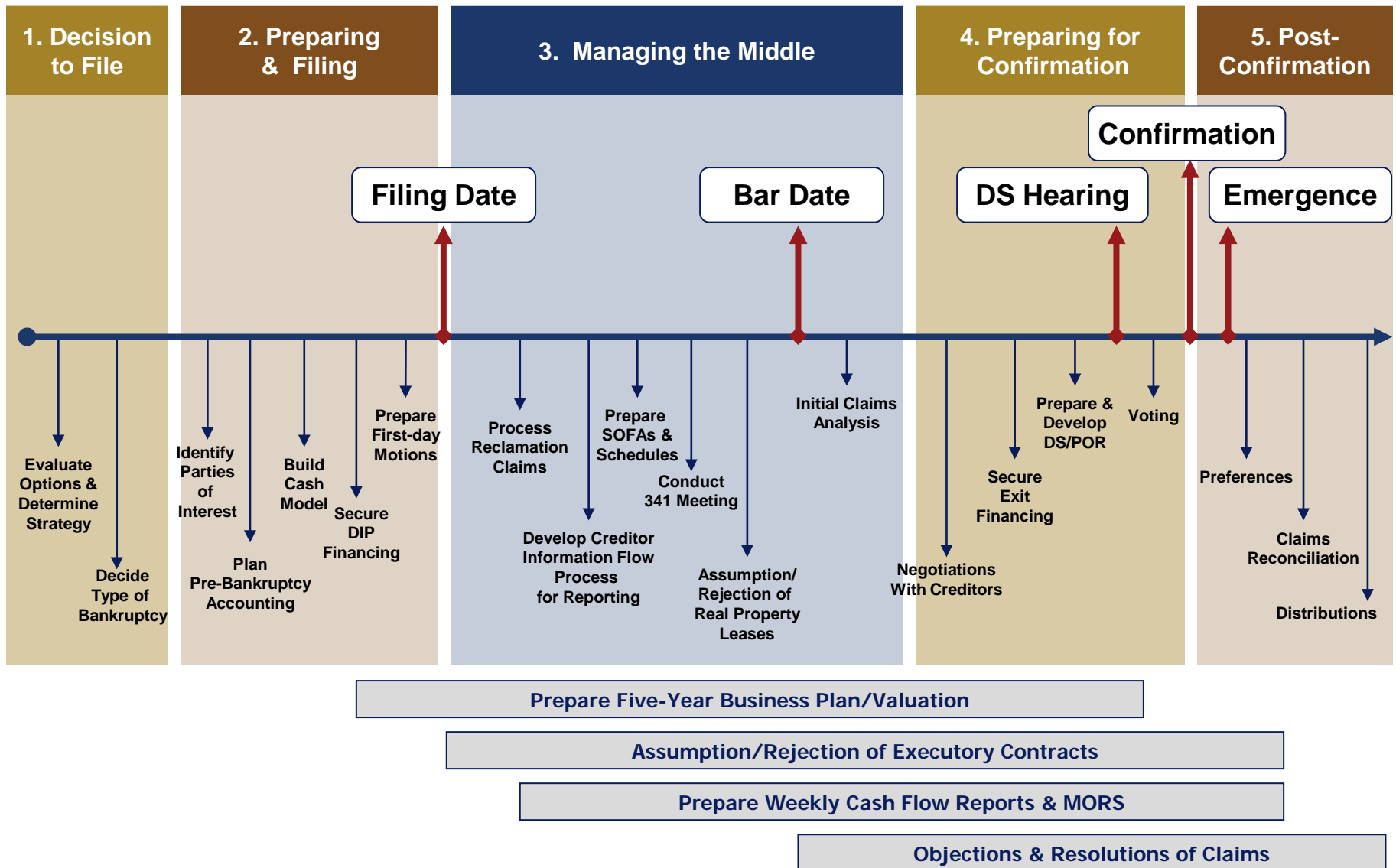
Kinds of Chapter 11 Cases (cont.)

- Conventional cases
 - Debtor forced to file before completing negotiations with stakeholders
 - In rare “free fall” cases, debtors file before obtaining a DIP financing commitment
- Liquidating cases
 - Use Chapter 11 to sell assets or business and distribute proceeds to creditors
 - May involve a filing and quick sale of a business as a going concern via a “363 sale” to preserve value, followed later by a plan or conversion to Chapter 7 to distribute proceeds or remaining assets, because there is no time to propose, solicit and consummate a reorganization plan due to rapid business deterioration or lack of post-petition financing

Overview of Chapter 11 Process



Bankruptcy Process and Timeline



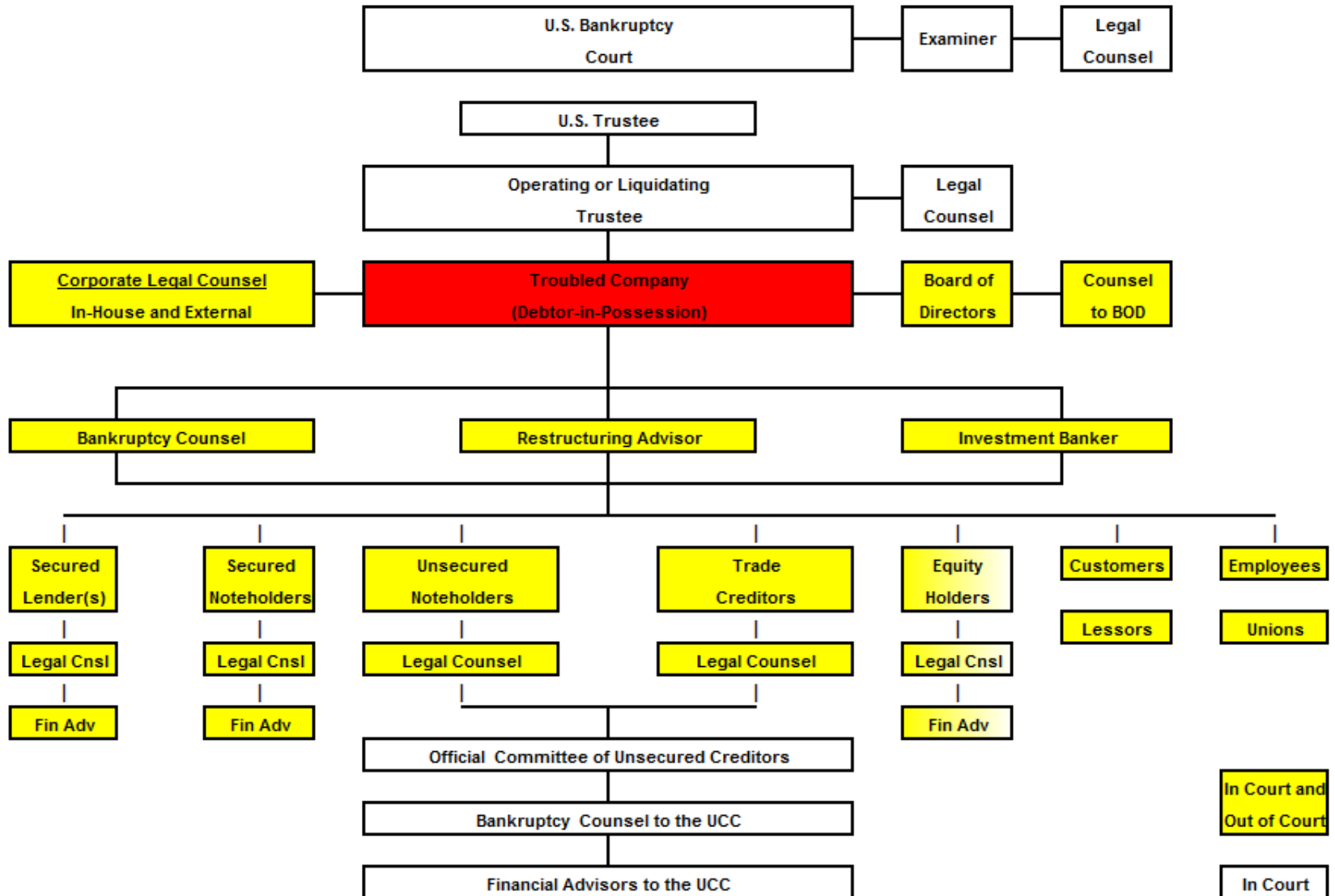
The Bankruptcy Court System

- The Debtor-In-Possession (Debtor)
- Bankruptcy Judge
- U.S. Trustee
- Unsecured Creditors Committee
- Other Committees
- Chapter 11 Trustee or Examiner
- Professionals
 - Attorneys
 - Restructuring Advisors
 - Investment Bankers
 - Accountants

Other Involved Parties

- Secured creditors
- DIP lenders
- Unsecured creditors
- Customers
- Suppliers and vendors
- Current and former employees
- Directors and officers
- Unions
- Ad hoc committees
- Plan investors/backstop parties
- Purchasers/stalking horse bidders
- Regulatory agencies (IRS, SEC, EPA, PBGC, etc.)
- Litigation plaintiffs
- The public/media

Chapter 11 Working Group

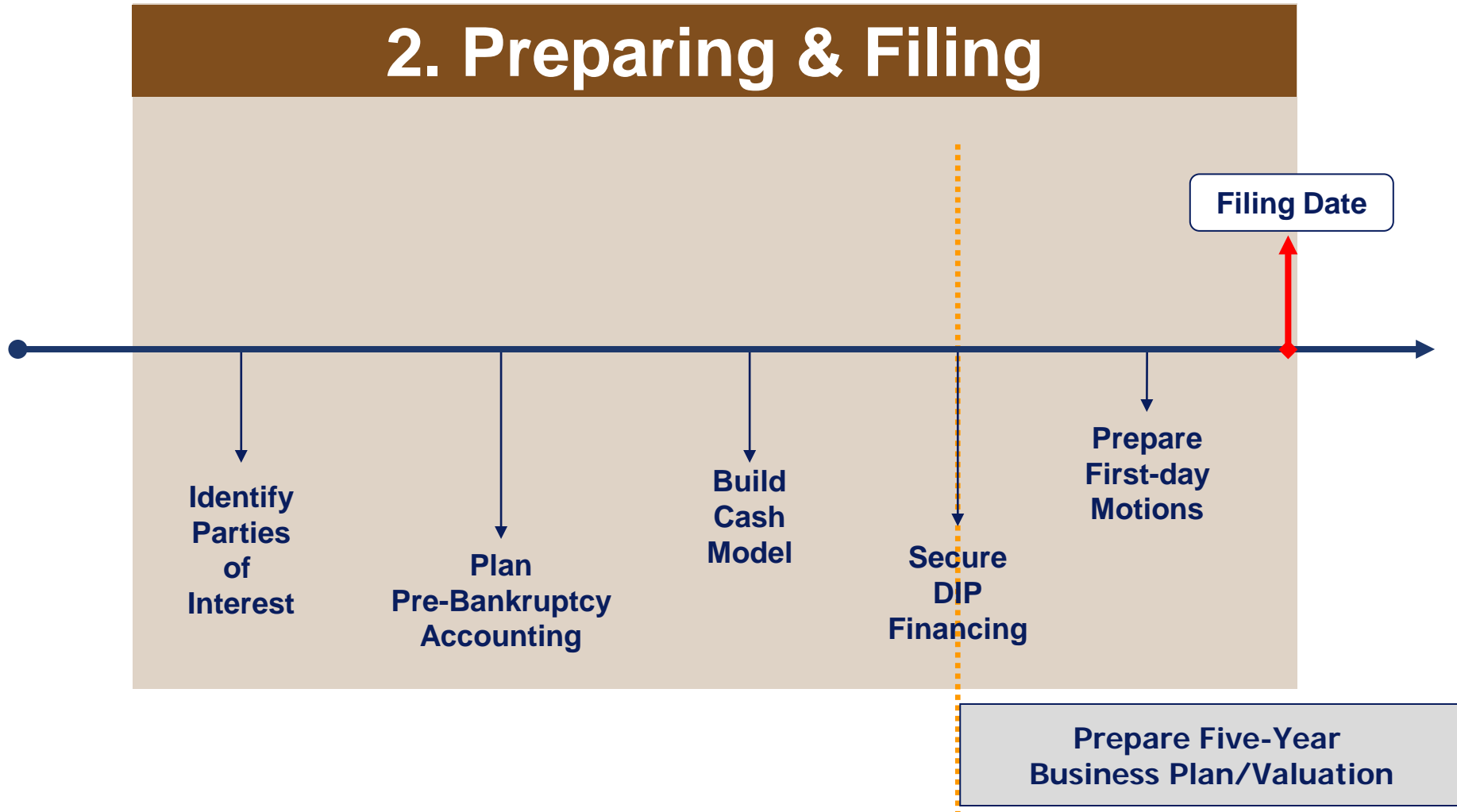


Preparing for a Filing and Filing



Filing – Timeline of Key Activities

2. Preparing & Filing



Filing – Key Events and Activities

**Identify Issues
to be Addressed
Before Filing**

**Secure DIP
Financing**

**Decide WHERE
& WHEN to File**

**Develop
Communication
Plan**

**Segregate
Accounts
Payable**

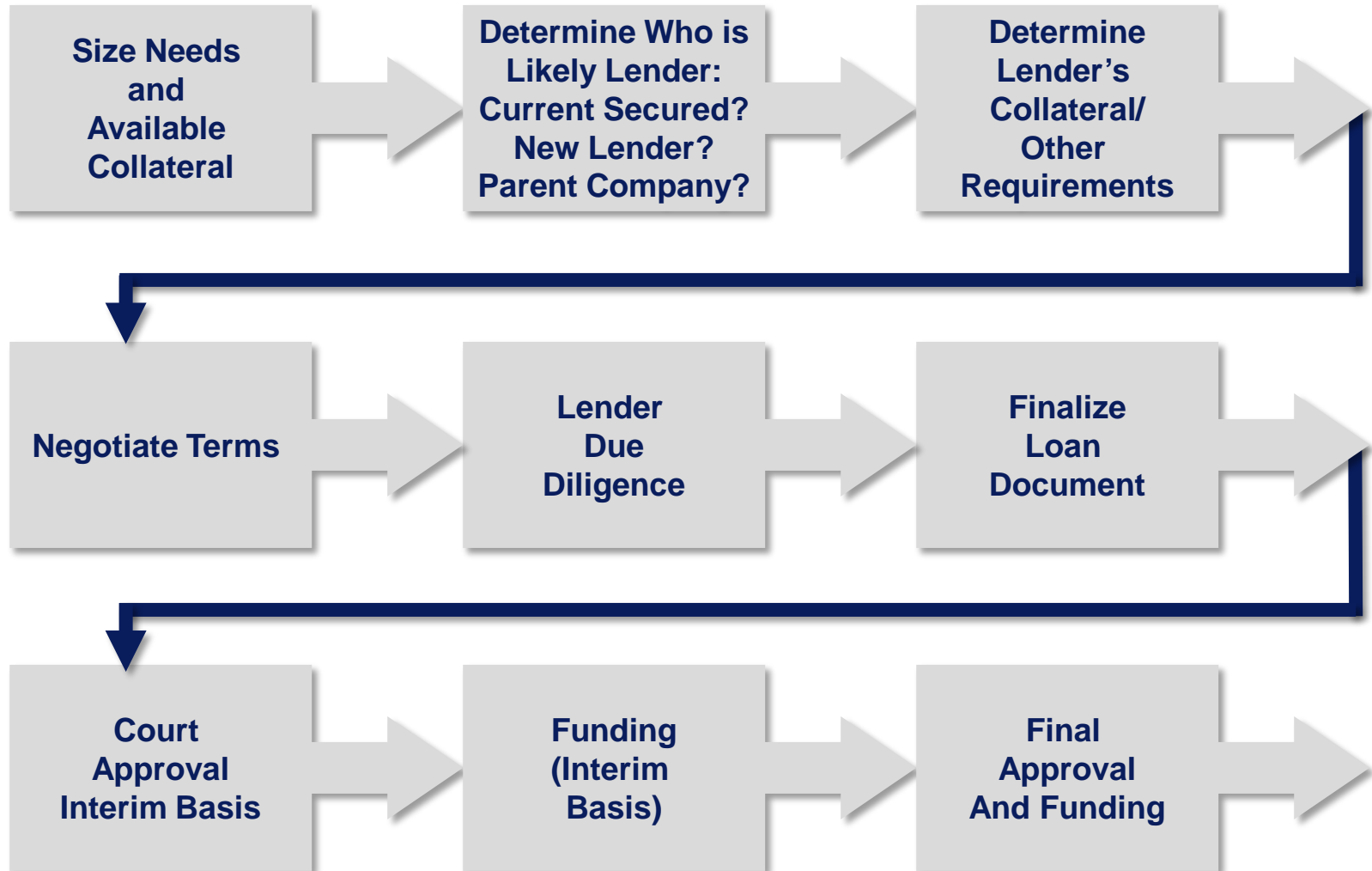
**Prepare
First-Day
Motions**

**Prepare
and File
the Petition**

**Prepare
Noticing
Matrix**

**Cash
Management/
Conservation**

Securing DIP Financing



Key First-Day Motions

- Cash Management
- DIP Financing/Use of Cash Collateral
- Utilities*
- Sales and Use Taxes
- Employee Wages and Benefits
- Retention of Professionals

Others to consider:

- Critical Vendors
- Employee Retention
- Continuation of Customer Practices
- Reclamation Procedures
- Mechanics, Contractors, Shippers and Warehousemen
- Ordinary Course Professionals

Other Procedural Motions

- Affidavit of Company Executive
- Joint Administration
- Consolidated Matrix of Creditors
- Additional Time to File “Statements and Schedules”
- Case Management
- Procedures for Interim Compensation of Professionals
- Foreign Enforcement of Automatic Stay

Preparation of Petition

A typical petition contains:

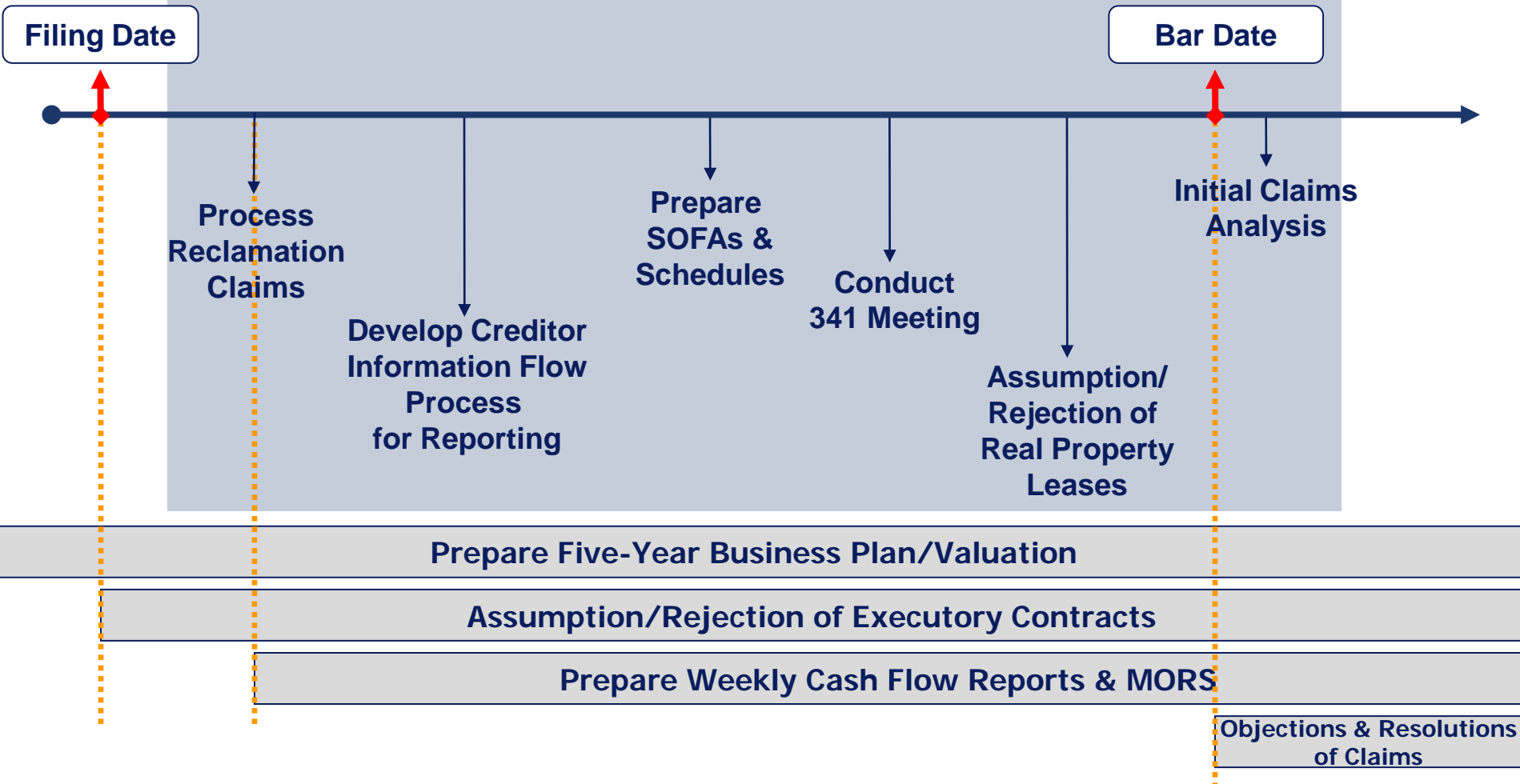
- Factual company information
- Chapter filed under
- Estimates on number of creditors, assets, debts
- List of 20 largest unsecured creditors by legal entity (or more if presented on a consolidated basis)
- List of equity security holders
- Resolution of Board of Directors

Core Proceeding



Core Proceeding – Time Line

3. Managing the Middle



Core Proceeding – Key Activities

**Implement
Required
Financial
Reporting**

**Complete
Schedules &
SOFAS**

**Prepare for
and Conduct
Section
341 Meeting**

**Report to
Various
Constituents**

**Evaluate
Un-expired
Leases and
Contracts**

**Claims Analysis
and Estimation**

Filing Creates Stake in the Ground

- 120 days – Debtor has exclusive right to file plan
 - 180 days to obtain acceptances of plan
 - “Exclusivity period” may not be extended beyond 18 months
- 120 days – To assume or reject non-residential real property leases
 - Limited ability to extend beyond 210 days
- 15 days – To complete “Statements and Schedules”
- 20 days – After petition date (or 45 days after receipt of goods) to file reclamation claims under §546(c)
 - May assert administrative claim for goods received within 20 days prior to filing under §503(b)(9)
- 90 days – Prior to filing for preference claims
 - 1 year for insiders

Court Approvals Required

Court approval required for any transaction deemed out of the “ordinary course” of business, such as:

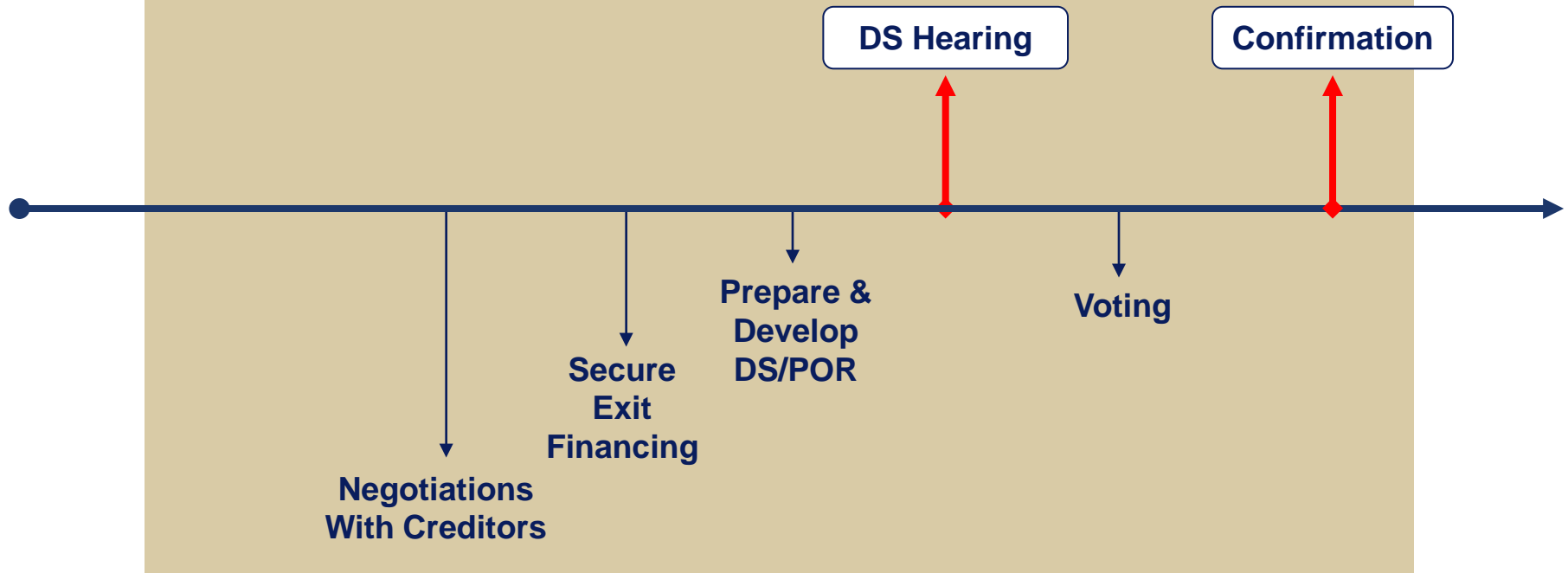
- Sale of assets, divisions or business lines
- Employment agreements
- Employee retention and management incentive plans*
- Hiring of professionals
- Pledging of assets to creditors

Preparing for Confirmation and Confirmation



Confirmation - Timing

4. Preparing for Confirmation



Prepare Five-Year Business Plan/Valuation

Assumption/Rejection of Executory Contracts

Prepare Weekly Cash Flow Reports & MORS

Objections & Resolutions of Claims

Confirmation – Key Events and Activities

**Determine
Basic Strategy
for Emerging from
Bankruptcy**

**Develop
Business
Plan/Valuation**

**Assume/
Reject
Executory
Contracts**

**Secure
Exit
Financing**

**Formulate
Plan of
Reorganization**

**Solicitation
and Voting**

Formulation of an Exit Strategy

- Debtors file Chapter 11 for different reasons (e.g., to reduce or change payment terms of debt or equity, to address mass tort problems, and/or to reject burdensome contracts or leases)
- Regardless of the reasons for filing, a large business debtor (usually in consultation with its major stakeholders) will go through the following steps in formulating a plan:
 - Development of business plan – Will always turn on (a) specific problems precipitating debtor's filing and (b) perceived solution(s) to those problems
 - Determination of the debtor's enterprise value – Determine how much value there is to distribute among the debtor's stakeholders
 - This usually leads to an analysis of the "fulcrum security"

Exit Strategy (cont.)

- Determination of a "liquidation value" as a benchmark against which enterprise value is compared for various confirmation purposes
- Formulation of new capital structure (e.g., how much and what type of new debt the reorganized company will carry) – often a matter of significant debate amongst the debtor and its stakeholders
- Negotiation of class treatment – At the early stages of plan negotiation, the debtor will begin to map out the proposed distribution to each creditor class
- Obtaining exit financing
 - Most business debtors will require some sort of financing upon emergence
 - Consideration of the form and terms of such financing, and the logistics of obtaining it, should be considered early on in the process

Plan of Reorganization

What

Describes debtor's proposed treatment of creditors

Issues

- **Business plan**
- **Exit financing**
- **Treatment of creditors**
- **Treatment of creditors under the plan vs. liquidation**
- **Feasibility**

Questions

What is the company's overall strategy?

What is its new capital structure? Debt? Equity?

Who will provide the exit financing?

How big is the pie? How will pie be divided?

Disclosure Statement

What

The Disclosure Statement is similar to a prospectus and is used to “sell” the plan to the debtor’s creditors

Contents

- Classes of claims
- Timing and distribution
- Alternative plans
- Voting procedures and deadlines
- Why the debtor’s plan is in the best interest of the claimants

Major Tasks

- 5-year projections (for valuation and feasibility analysis)
- Liquidation analysis (for “Best Interest” test)
- Claims reconciliation and distribution analysis

Plan Voting

- Goal of case is to confirm a plan
- Plan will classify claims and interests – voting and treatment will be on a class basis
- Votes are solicited through Court-approved Disclosure Statement
- To approve, within a class
 - More than 1/2 in number of claims actually voted
 - At least 2/3 in amount of claims actually voted

Key Confirmation Requirements (§1129)

- Good Faith (§1129(a)(3)) – Plan must be proposed in good faith and not by any means forbidden by law
- Best Interest (§1129(a)(7)) – With respect to any holder of an impaired claim or interest that votes against the plan, or that is deemed to vote against the plan, the plan must provide such holder with at least as much value as under a Chapter 7 liquidation
- All Classes Either Unimpaired or Have Accepted (§1129(a)(8)) – If this requirement cannot be met, the Debtors may "cramdown" non-accepting classes
- Full Payment of Priority Claims (§1129(a)(9))

Key Confirmation Requirements (cont.)

- At Least One Impaired Class of Creditors Accepts (§1129(a)(10))
- Feasibility (§1129(a)(11))
 - Must be likely that confirmation of the Plan will not be followed by the liquidation or the need for further financial reorganization of the Debtors, unless liquidation is specifically contemplated by the Plan
 - The Plan must have a reasonable prospect of succeeding within a reasonable period of time

Best Interest Test (§1129(a)(7))

For each impaired class of claims, estimated recoveries under the Plan are compared to estimated recoveries under a hypothetical Chapter 7 liquidation by a Chapter 7 trustee

	Low	High
Liquidation Value of Assets	\$xxx,xxx	\$xxx,xxx
Less: Trustee Fees (3%)	(x,xxx)	(x,xxx)
Less: Other Liquidation Costs	(x,xxx)	(x,xxx)
Value Available to Creditors	xxx,xxx	xxx,xxx
Secured Claims (from collateral)	xx,xxx	xx,xxx
Recovery %	100%	100%
Priority Claims	xx,xxx	xx,xxx
Recovery %	100%	100%
Unsecured Claims	xx,xxx	xx,xxx
Recovery %	25%	50%

Cramdown (§1129b)

- Plan may be confirmed without acceptance of all classes through “cramdown”
 - Acceptance by at least one impaired class required
 - Plan must not “discriminate unfairly” (all similarly situated creditors must be treated alike)
 - Plan must be “fair and equitable” (compliance with “absolute priority rule,” which requires that claims and interests of lower priority not receive a distribution if claims or interests of higher priority did not receive a full recovery)

Cramdown (§1129b) (cont.)

- Cramdown on secured claims (sometimes called "cram up") is available but the secured creditor must receive the present value of the value of its collateral or the "indubitable equivalent" of its claim; this value can take different forms and has been the subject of many court opinions
- New Value Exception to the Absolute Priority Rule
 - Equity holders may retain equity in the reorganized entity by making a substantial contribution to the newly reorganized entity, despite the fact that unsecured creditors did not consent to the proposed reorganization and unsecured creditors did not receive full payment

Absolute Priority Rule

Pursuant to the Absolute Priority Rule, without the consent of senior classes, a junior class of claims (or interests) generally cannot receive a recovery in a restructuring unless all senior classes have been paid in full

Secured Debt Claims

Administrative Claims

Unsecured Debt Claims

Trade Debt Claims

Subordinated Debt Claims

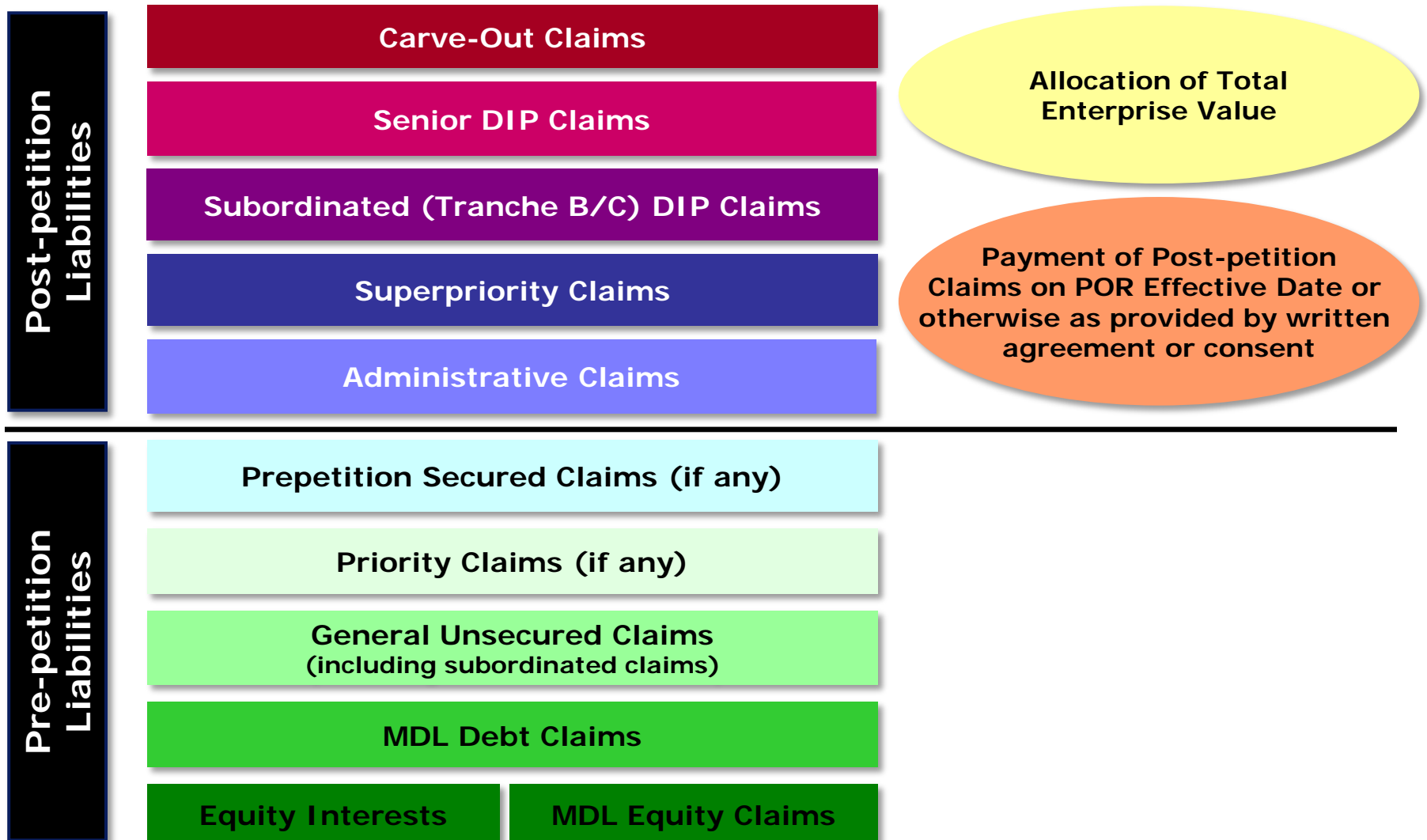
MDL Claims Arising from Debt Securities (§ 510(b))

**Common Equity
Interests**

ERISA Claims

**MDL Claims Arising from
Common Equity (§
510(b))**

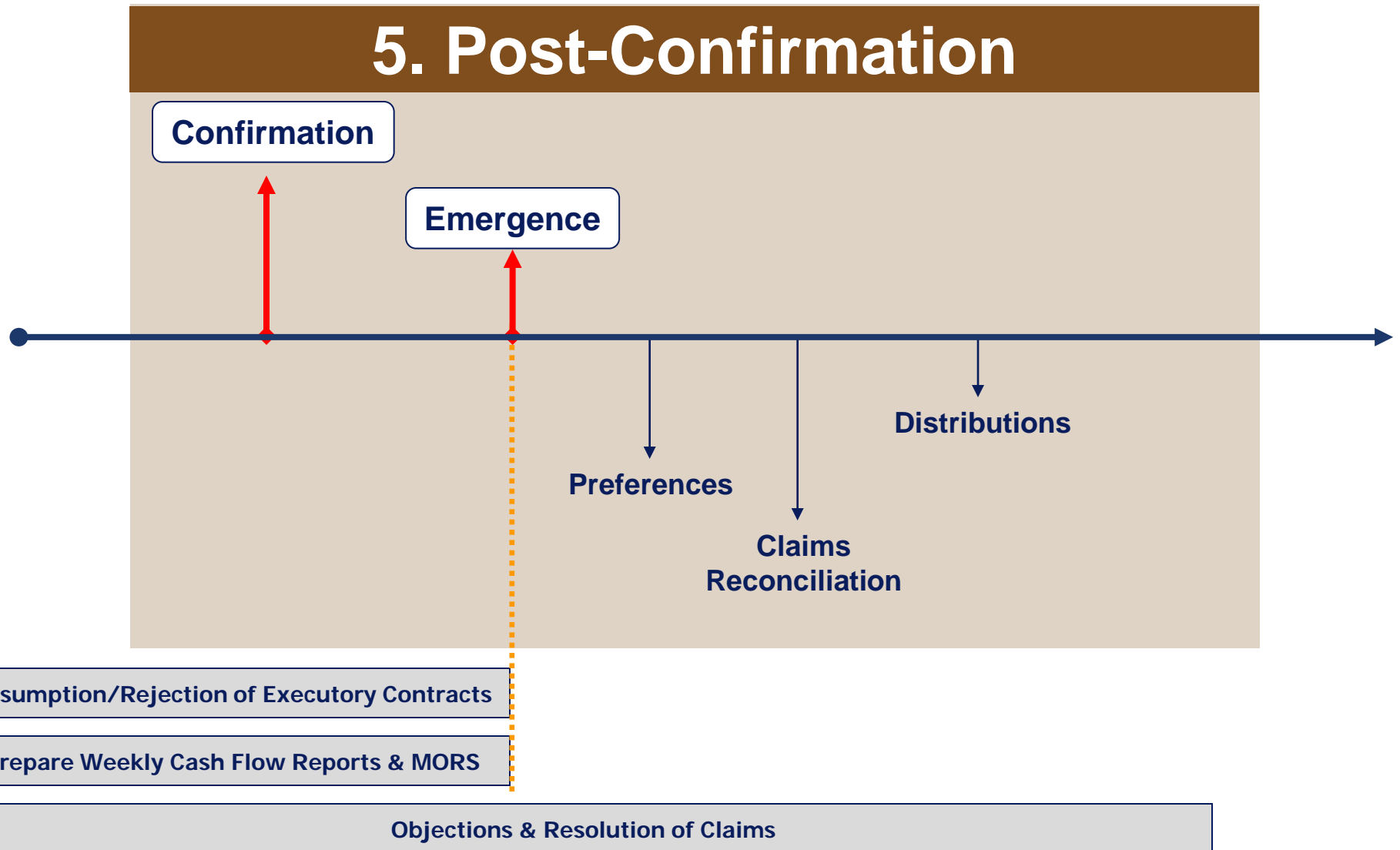
Absolute Priority Waterfall



Post-Confirmation



Post Confirmation - Timeline



Post Confirmation – Key Activities

**Fresh
Start
Accounting**

**Complete
Preference
Analysis**

**Pursuit of
Preferences**

**Claims
Reconciliation**

Distributions

**Making
It
Work**

Avoidance Actions

- Debtors have power to avoid preferences and fraudulent conveyances
- Preferences – Includes transfers:
 - within 90 days prior to bankruptcy filing (one year for insiders)
 - on account of antecedent debt
 - that allow transferee to receive more than in hypothetical liquidation
 - not a transfer in the ordinary course of business
- Fraudulent Conveyances – Transfer prior to commencement of case, made either:
 - with actual intent to hinder, delay or defraud (actual fraud), or
 - while debtor was insolvent and for which debtor did not receive reasonably equivalent value (constructive fraud)

Q&A

