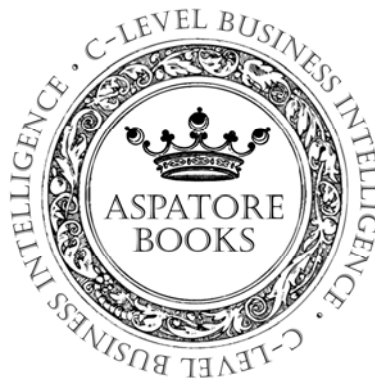


I N S I D E T H E M I N D S

The Roles and Motivations of Key Players in Bankruptcy Cases

*Leading Lawyers on Overseeing Bankruptcy, Financial
Restructuring, and Reorganization Proceedings*



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Navigating within the Zone of Insolvency

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Most bankruptcy practices focus on companies that have entered the “zone of insolvency.” Either the liabilities of the business exceed its assets, or the business is unable to pay its debts as they come due. Restructuring attorneys representing the business (referred to as the “debtor”) work with management to identify the optimal strategic alternative for the company. In some situations, that strategy will be a restructuring of the debtor’s balance sheet. In other cases, the debtor will pursue a change in its business plan, a sale of specific assets or operations, or a sale of the business as a going concern. Sometimes, the debtor will consider a merger or other strategic combination. When all else fails, the debtor may simply need to proceed to immediate liquidation. In some situations, these strategic alternatives are best pursued in the context of a bankruptcy proceeding. In others, an out-of-court restructuring or sale makes more sense. The debtor’s attorneys evaluate the costs, benefits, opportunities, and risks of each alternative and help their client chart the best course.

When restructuring attorneys represent a creditor, their mission is defined largely by the nature of the creditor’s current relationship with the debtor. Where the companies have an important ongoing relationship (pursuant to a supply agreement, license, or otherwise), the creditor may focus on supporting the debtor’s reorganization efforts and making sure the debtor will be capable of continuing to perform its obligations. Where the creditor no longer does business with the debtor, the attorneys’ job is much more narrowly defined—the attorneys seek to maximize the amount of their client’s recovery and to expedite the timing of that recovery. Sometimes, these objectives are best achieved through active litigation with the debtor or opposition to the debtor’s reorganization strategy. Other times, the client fares better through a negotiated resolution of its issues with the debtor. Again, the job of the attorney is to compare the relative merits of litigation and settlement/support of the debtor, and give good counsel as to which path to take.

When restructuring attorneys represent a trustee or other fiduciary responsible for the interests of creditors (or sometimes equity holders), they seek the outcome most advantageous for their clients. Just as when they represent a creditor, they usually seek to improve the amount and timing of the beneficiaries’ recovery. However, unlike an engagement for a single

creditor, attorneys must consider the best interests of the beneficiaries as a whole, without reference to particular individual concerns.

A debtor and its stakeholders (creditors, equity holders, employees, vendors, licensors/licensees, and the like) must evaluate their rights and obligations under the Bankruptcy Code, the Uniform Commercial Code, and other applicable state law. These authorities create both problems and opportunities for each of these parties. Restructuring attorneys create value for their clients by identifying where the leverage lies under applicable law—the arguments that are available to each stakeholder to dictate the outcome of the dispute at hand. They also create value by using those arguments—either in negotiation or litigation—to help clients achieve their desired treatment in the restructuring process.

For example, suppose a restructuring attorney represents a junior secured creditor. The client has made a \$10,000,000 term loan to the debtor, secured by the debtor's accounts receivable. Assume further that the senior secured creditor has made a \$15,000,000 term loan to the debtor, secured by the debtor's accounts receivable and real estate. Finally, assume that the accounts receivable are worth \$15,000,000 and the real estate is worth \$15,000,000. On these facts, in the event of insolvency and default, the senior secured creditor would have the right to seek recovery from either the accounts receivable or the real estate. If it proceeded against the accounts receivable, the senior secured creditor would be paid in full, but the client—the junior creditor—would receive nothing. However, by using the legal doctrine of marshalling, the attorney may be able to force the senior creditor to proceed first against the real estate, leaving the accounts receivable for the junior creditor and assuring that both creditors will be paid in full. For the client, the use of this legal theory would literally be the difference between zero recovery and payment in full.

Take another example. Let's say the restructuring attorney represents an unsecured creditor. Let's assume the debtor's assets are worth \$20,000,000. Let's assume further that there are creditors holding claims against the debtor aggregating \$40,000,000. Finally, let's assume one of these creditors—owed \$20,000,000—asserts a first priority lien on the debtor's assets. If this lien is valid, this creditor will be paid in full, and the other

unsecured creditors—including the client—will receive nothing. However, if the restructuring attorney can identify a defect in the lien (for example, perhaps the creditor did not obtain a signed security agreement from the debtor), the attorney may be able to attack that creditor's secured position. If the attorney succeeds in that process, that creditor will be treated as unsecured, and all creditors will receive a 50 percent distribution.

These examples represent zero-sum games. What one creditor gains, another creditor has lost. Sometimes, though, a given engagement presents an opportunity to create value for multiple stakeholders and constituencies. For example, suppose the debtor owns a tract of land that is zoned for residential use. Assume, further, that the value of this land will triple if the property can be rezoned for mixed or commercial use. Instead of fighting with the debtor over its ongoing operations or use of cash, an enterprising creditor might join forces with the debtor and seek to facilitate the rezoning of the property (through forbearance or even additional extensions of credit). The idea here is that the rezoning will increase the value of the debtor's asset pool and thereby assure a larger recovery for all of the creditors in the case.

To succeed in this practice, a restructuring lawyer must have a good understanding of the objectives of each of the stakeholders, as well as the legal landscape governing the efforts to reach those objectives. An excellent lawyer then uses this knowledge of people and principles to construct solutions. Sometimes those solutions take the form of global, multi-party agreements. Sometimes those solutions require contested federal litigation. In either case, the restructuring lawyer seeks to chart the optimal course for his or her client.

The major mistake clients make in restructuring scenarios involves timing—the failure to acknowledge at a sufficiently early point that the debtor requires serious structural change. In the restructuring arena, time is power—power to implement changes to the business plan, explore and pursue new refinancing and recapitalization alternatives, and to pursue mergers or other strategic combinations. More time equals more strategic alternatives for the debtor and its stakeholders. It necessarily follows that, when the debtor and its stakeholders defer consideration of the hard issues

until the problems are very advanced, there are fewer options for all parties concerned.

Another mistake that occasionally occurs is the erroneous view that restructuring, by itself, will make a troubled company successful and profitable. Companies rise and fall on the quality of their business plan and strategic vision. Where those elements are lacking or deficient, no amount of restructuring will save the firm. Restructuring can help a sound business eliminate certain obstacles to its success. For example, an overleveraged company can pursue an equity infusion. A company that has over-expanded can sell some of its divisions and return to the core business in which it first succeeded. A company that is strangling under the economic weight of an ill-advised contract or lease may be able to shed the burdens of that contract. But all these strategic moves (useful as they may be) are meaningless if the debtor is unable to succeed at its core business. Restructuring creates an opportunity for the debtor to succeed, not an absolute guaranty of success.

It goes without saying that an excellent restructuring lawyer must remain fully abreast of the law—reading trade publications and new decisions, and participating in continuing legal education programs. I also think it is important to remain abreast of economic trends and current world and business news. The *Wall Street Journal* is indispensable reading, as are a variety of Internet resources. Perhaps most importantly, restructuring lawyers learn from observing other cases—their own and those of their colleagues. What were the major problems or issues in these cases? How did the stakeholders bridge the gaps between them? An effective restructuring lawyer remembers these problems and solutions, and saves them for when they can be used to their advantage once again.

Key Players

When a debtor decides to restructure—either inside or outside bankruptcy court—a number of stakeholders play an active role. These stakeholders include (i) the debtor's management and board of directors, (ii) its equity holders, (iii) its unsecured creditors, (iv) its vendors, suppliers, licensors, licensees, landlords, and other contract parties, (v) its secured creditors,

(vi) its employees, (vii) taxing authorities and other governmental actors, and (viii) its insurers and litigation opponents. Where the restructuring takes place inside bankruptcy, additional key players join the game, including (i) official committees, both of debt and equity holders, (ii) trustees, (iii) the Office of the U.S. Trustee and, perhaps most important, (iv) the bankruptcy judge.

Where the debtor is a smaller company (either in terms of capitalization or gross revenue), some of these constituencies may be less active in the restructuring process or choose not to participate at all. In most instances, participation in the restructuring process is driven by a simple cost/benefit analysis. What is the value of the stakeholder's interest in the debtor? What is the range of potential outcomes for the stakeholder? In short, what are the relative costs and benefits of participation, as opposed to non-participation? Stakeholders generally decide to get involved when they believe an active role in the restructuring process will materially enhance the value of their interest in the debtor.

Where the debtor is a public company, the same dynamics drive the quality of stakeholder participation. However, because of the debtor's Securities and Exchange Commission reporting requirements, there is generally far greater transparency in the debtor's decision-making process. This transparency means smaller stakeholders often have a much better sense of the debtor's restructuring progress than they would if the debtor were privately held. Where the debtor's restructuring strategy is well executed, or where the smaller stakeholders believe their interests and concerns are adequately addressed, such stakeholders may elect to stay on the sidelines for the time being. However, where the smaller stakeholders feel their concerns are being ignored or that the value of their interests is being eroded, such stakeholders may become more active. They may choose to form committees, retain counsel, and take such other action as may be required to assure themselves a seat at the table. Simply stated, the additional information flow generated by a publicly held debtor, more often than not, acts as a spur to additional stakeholder involvement.

Management and the Board of Directors

In a restructuring scenario, the debtor's board of directors must make threshold decisions as to whether to authorize or disapprove of the key elements of the proposed restructuring. Should the debtor liquidate or continue operating as a going concern? If the debtor is to liquidate, should its assets be sold on a piecemeal or going concern basis? Should a merger or other strategic combination be pursued? Should the debtor obtain new financing or consider a new equity infusion? The board will need to carefully review and consider these alternatives, and authorize those courses of action that appear optimal. Senior management does the legwork on the strategic alternatives—identifying different courses of action, researching the costs and benefits of each, and implementing those decisions approved by the board—through negotiation, litigation, a bankruptcy filing, or otherwise.

All the while, senior management must continue performing its operational functions. Notwithstanding the restructuring, the managers must continue executing their business plan and running the company. Because this dual role can be so time-consuming and disruptive, many debtors retain or designate a chief restructuring officer. Sometimes he or she will be selected from a management consulting or turnaround firm engaged by the debtor. Other times, he or she is selected from internal resources. A chief operating officer or chief financial officer may be a likely candidate, owing to that individual's prior involvement in the debtor's credit facilities and capital structure. The chief restructuring officer takes primary responsibility for managing the debtor's restructuring efforts and liaising with the board and other stakeholders as to the progress of their negotiations. In a bankruptcy proceeding, the chief restructuring officer is usually designated as the "responsible person" in the case. In so doing, he or she frees the chief executive officer to focus on the fundamentals of the debtor's business.

A corporate restructuring of any size or complexity poses particular challenges for the directors and senior management. When a company enters the zone of insolvency, it is widely accepted that the duties of directors and officers shift. Instead of focusing on benefiting the shareholders, the directors and shareholders of an insolvent company must

pursue, first and foremost, the best interests of the creditors. The duties of the directors and officers to the shareholders do not disappear; however, the interests of equity must take a back seat to the best interests of creditors. Thus, in determining the key drivers of a restructuring strategy, the board and management must select those options that assure an optimal recovery for the creditors.

A restructuring or bankruptcy places the directors and senior management in a fishbowl. These individuals are closely scrutinized by the other stakeholders to determine whether they have fulfilled these fiduciary duties. In many instances, a failed restructuring is followed by lawsuits against the director and officers. These lawsuits, which may be brought by representatives of the unsecured creditors, equity holders, or both, generally assert claims for breach of fiduciary duty and the like. In bringing these lawsuits, the plaintiffs second-guess the debtor's leadership and argue that the strategic choices made by such leadership were not in the best interests of the company's stakeholders.

In addition to the risk of being second-guessed or sued, the debtor's leadership also faces uncertainty over compensation arrangements. In a hotly contested restructuring scenario, it is not always clear whether the debtor will survive, or how long it will continue to operate on a going concern basis. Accordingly, to retain its talented leadership, a debtor must implement some form of key employee retention plan, which may also include some form of success or emergence bonus. These arrangements are subject to bankruptcy court approval. Recent changes to the Bankruptcy Code have also imposed a much stricter burden of proof for establishing that the key employee retention plan is necessary. In addition, the new Bankruptcy Code provisions have placed additional conditions and limitations on such plans.

Equity Holders

In many corporate reorganizations, a debtor rehabilitates itself through a restructuring of its balance sheet. Often, such restructuring will involve new shares of the debtor's stock being issued to new investors, unsecured creditors, or both. Thus, at a bare minimum, a debtor's existing equity

holders face substantial dilution of the value of their interests. Where the debtor is insolvent (such that its liabilities exceed its assets), the existing equity is, by definition, valued at zero. In such a scenario, a debtor may also elect to completely extinguish the existing equity, and to issue new stock to its other stakeholders.

Thus, the threshold question for equity holders in a corporate reorganization is how their existing equity will be valued. As long as an argument can be made for the equity having a meaningful positive value, equity holders can be expected to band together (through a formal or informal committee) and to insist that this value be preserved for their benefit. Where continued operation of the debtor's business may preserve or enhance the value of their interests, the equity holders may strongly advocate for such operation. Where the equity arguably has a zero or negative value, the equity holders will be strongly incentivized to help the debtor buy time, in hopes that future developments will strengthen the argument that there was actually positive equity value as of the commencement of the reorganization proceeding.

In playing this role, the equity holders often serve as a counterweight to certain secured creditor constituencies and other stakeholders who may, in some situations, seek a speedy end to the restructuring or bankruptcy process. Secured creditors, by definition, tend to focus primarily on the value of their collateral. Where ongoing operations risk eroding that collateral value, secured creditors may often advocate for a liquidation, or a greatly expedited resolution of the reorganization proceeding. By contrast, equity holders have far less risk in the continued operation of the business. These equity holders have no collateral to be eroded and stand only to increase the value of their interest through such ongoing operations. In effect, the equity holders are playing with house money at this point in the case, and can be expected to behave accordingly.

Unsecured Creditors

Like equity holders, unsecured creditors are focused intently on value—in this case, the value of the debtor's assets. That valuation will drive the determination of how much the creditors are entitled to receive through the

restructuring or reorganization. Also like the equity holders, unsecured creditors are generally far more likely to favor continued operation of the debtor, in hopes of maximizing the return to stakeholders. (An exception would be where current asset value is sufficient to fund a meaningful distribution to creditors, and ongoing operations are expected to result in operating losses, which will erode that distribution).

The primary difference between the two constituencies is one of priority. Generally speaking, unsecured creditors must be paid in full before equity holders receive dollar one of their distributions.¹ Thus, when the debtor's asset value is only slightly in excess of the secured debt, equity will be completely out of the money, and relegated to a seat on the sidelines. By contrast, the unsecured creditor constituency will be an active participant in the case. Their interest may only be worth pennies on the dollar (relative to the face amount of their claims), but they can be expected to work hard to preserve and maximize that interest. The unsecured creditors often assert these rights by forming a committee to speak for them on these assets. The committee retains its own professionals and takes an active role in negotiating the terms of the debtor's plan of reorganization. The committee will also have a right to be heard on all of the debtor's other operational decisions, objecting where necessary.

In a perfect world, the debtor and committee develop a productive working relationship, such that they consult prior to major operational decisions being made and limit their litigation with one another to either substantive economic disagreements or true negotiating impasses. However, in some cases, the relationship between these stakeholders is strained or nonexistent, and disagreement and litigation are far more frequent. That level of contentiousness inevitably lengthens the reorganization process, adding to the expense for all parties concerned. However, there are some situations where such contentiousness may be unavoidable (i.e., where the committee believes the debtor's leadership is breaching its fiduciary duties, or where the debtor and committee have a profound disagreement as to asset value).

¹ These constituencies may bargain with each other as part of the reorganization process, such that equity holders could start receiving some sort of distribution, even though unsecured creditors have not been paid in full.

The economics of most reorganizations dictate that the unsecured creditors are heard primarily through their official committee.² The debtor effectively pays for the professionals retained by these committees at no additional cost to the creditors (other than the use of the debtor's assets for this purpose). Thus, the committee theoretically speaks for the unsecured creditors without charging them for that service. Nevertheless, there are sometimes situations where an individual creditor wishes to be heard and believes the committee is unable or unwilling to voice that creditor's view. The Bankruptcy Code specifically empowers individual creditors to appear and be heard on any issue in the case. Individual creditors often avail themselves of this right, particular where such creditors are displeased with the committee's approach or affected by a specific issue the committee cannot raise.

Vendors, Suppliers, Licensors, Licensees, Landlords, and Other Contract Parties

In any restructuring scenario, the unsecured creditors can usually be divided into two major categories: those creditors who have substantial ongoing relationships with the debtor, and those who do not. The most common examples of the first category are vendors, suppliers, licensors, licensees, landlords, and other parties to contracts with the debtor. All of these stakeholders have something in common. Their relationship with the debtor is about more than money. The vendors and suppliers provide services and products to the debtor, and may have an ongoing economic interest in doing so. The licensors and licensees have agreements with the debtor for specified use of intellectual property. The landlords lease property to the debtor, usually for commercial use. The other parties have some sort of ongoing contractual relationship with the debtor.

In a restructuring scenario, each of these stakeholders must confront a threshold decision: do we want to continue doing business with this company? If the answer to that question is "Yes," the stakeholder can be expected to take a relatively passive role in the reorganization—supporting the debtor's overall business plan and making such changes or adjustments

² The same can be said of the equity holders.

to the relationship as are necessary to meet the debtor's business needs. If, by contrast, the stakeholder no longer wishes to do business with the debtor, the landscape of their relationship changes dramatically. Now the stakeholder can be expected to go on the offensive against the debtor. The stakeholder may request that the debtor make an immediate decision as to whether it intends to maintain the contractual relationship. If the debtor proposes to keep the relationship, the stakeholder may challenge the quality or sufficiency of the debtor's continued performance. Where the facts and law permit, the stakeholder may even seek to terminate the contract.

Whether active or passive, confrontational or supportive, each of these contract stakeholders ultimately seeks to clarify the nature of its ongoing business relationship with the debtor. Where that relationship is mutually beneficial, it can be expected to pass through the restructuring process relatively unscathed. Where either party is dissatisfied with the relationship, further negotiation and, potentially, litigation are likely.

Secured Creditors

Under applicable bankruptcy and non-bankruptcy law, secured creditors derive their rights from the value of their collateral. If a secured creditor repossesses and sells its collateral, such creditor is entitled to apply the sale proceeds to its debt.³ Thus, in any restructuring, the secured creditors will expect and insist that they receive payments in an amount not less than the aggregate value of their collateral.

Where the collateral is fixed and unchanging, this principle is not difficult to administer. However, many types of collateral change form in the course of a debtor's operations. For example, a debtor might purchase inventory, turn that inventory into work in progress, cycle that work in progress into a finished order, and then sell that product, thereby generating a receivable. Where the debtor is making money on an operating basis, collateral value should stay constant (or even improve), and all is well. Where the debtor is

³ Multiple secured creditors can assert liens in the same collateral. In that event, the proceeds of the collateral must be distributed in accordance with applicable laws of priority.

losing money and no new credit is available, the receivables may end up being used to subsidize operating losses, resulting in an overall erosion of the collateral base.

Thus, in a restructuring scenario, every secured creditor faces a threshold question of timing: am I better off taking my collateral now (through a foreclosure or other forced liquidation of the debtor's assets) or working with the debtor to permit further operation as a going concern? Secured creditors tend to be far more conservative and risk-averse than unsecured creditors or equity holders. If they can recover the full value of their collateral now, secured creditors may look skeptically at the prospect of future operations, not to mention additional extensions of credit.

Given this inherent structural bias in favor of early foreclosure and liquidation, why would a secured creditor choose another strategic path? Several reasons come to mind. First, a distress sale of the collateral almost always assures the lowest possible recovery on these assets. In many situations, that reduction in collateral value can mean the difference between payment in full and some sort of deficiency. For another thing, the Bankruptcy Code creates tools by which a debtor can use collateral over the objection of its lenders. Specifically, the code permits continued operations and use of collateral, so long as it can be proven that the lender is "adequately protected"—that is to say, the value of the lender's lien will not be eroded through the continued operations. The code also may permit, under certain circumstances, the restructuring of the secured debt over an extended period, provided that (i) the lender retains its liens, (ii) the lender is paid a rate of interest sufficient to provide reasonable compensation for the risk, (iii) a class of creditors votes in favor of the debtor's restructuring, and (iv) other technical requirements of the Bankruptcy Code are satisfied. Where the debtor fails to satisfy the requirements of the code, though, the proposed reorganization may be rejected by the bankruptcy court. In that event, the debtor may be forced to liquidate.

Faced with these risks and uncertainties, many secured creditors find it more prudent to strike a deal for the continued use of their collateral by the debtor. For their part, faced with the risk of liquidation and foreclosure, many debtors find it worthwhile to hedge their bets and structure a form of

plan treatment and adequate protection the lender will find palatable. Where the debtor and its secured creditors do not see eye to eye, the bankruptcy court will end up deciding whether the proposed treatment of the secured creditors is reasonable, sufficient, and in accordance with applicable law.

Employees

The debtor's employees have two key elements on their agenda. First, in most instances, these employees wish to retain their jobs. Given that desire, it logically follows that these employees also wish to see the debtor's proposed restructuring succeed. However, where the employees have accrued substantial retirement, pension, or other benefits, these employees inevitably have a second desire. They wish to retain as much of these vested rights as possible, and they will fight hard to do so.

The problem, of course, arises from the conflict between these desires. Where a debtor has substantial unfunded or under-funded legacy obligations, full payment of these obligations may jeopardize the debtor's restructuring. Yet the employees' vested rights may be substantial—so much so that it makes greater economic sense to object to the attempt to modify these rights, even at the risk of potentially blocking the proposed restructuring plan. Given the obviously vital role the employees play in any restructuring, there are strong incentives for management and labor to come together on the terms of any modifications to the treatment of employee benefits. Acting through unions or committees, employees must balance the costs and benefits of litigation against the terms of their proposed treatment under the restructuring plan. This process is complicated by the fact that the employees sometimes must confront a “lose/lose choice”: (i) make peace and forfeit economically crucial rights or (ii) make war and potentially destroy the company and eliminate their jobs.

Taxing Authorities and Governmental Actors

In the restructuring arena, governmental actors take two forms: those primarily focused on recovering money, and those pursuing other governmental interests. The first category almost always includes relevant

taxing authorities, and may include any other governmental agency with a claim against the debtor. Some of these agencies are secured. Others have priority unsecured claims (meaning they have no collateral but are still required to be paid ahead of unsecured creditors under applicable law). Still others hold general unsecured claims. These agencies generally behave like creditors—their primary focus is to maximize and expedite their eventual recovery in the case.

The second category includes governmental agencies seeking to enforce an element of their regulatory or police power. For example, the Environmental Protection Agency might seek to assure that the purchaser of the debtor's real estate continues remediation efforts begun at the site. The Securities and Exchange Commission might have concerns about a proposed registration of new equity in the debtor. The city of Chicago might disagree with a contemplated rezoning or change in use of one of the debtor's locations. In each of these examples, and others like them, the governmental actor tries to pursue its objective through the restructuring process and opposes the restructuring to the extent necessary to attain that objective. Unlike other stakeholders, a governmental actor pursuing a police or regulatory power objective has little incentive to compromise based on economics. Rather, through negotiation or litigation, a governmental actor of this sort will focus exclusively on whether its specific governmental issue has been properly addressed.

Insurers and Litigation Opponents

In any restructuring situation, one of a debtor's most valuable assets is its insurance program. These policies provide protection against ruinous liability claims and offer an additional source of recovery for many creditors. Under most forms of insurance, the bankruptcy filing does not offer the insurer a basis to cancel the coverage. Indeed, the bankruptcy filing should be a neutral event that neither enlarges nor reduces the scope of coverage provided.

The bankruptcy filing does establish an automatic stay—a temporary bar on most pre-bankruptcy litigation against the debtor. Thus, both the debtor and the insurer have an interest in working together to make sure this hiatus

does not interfere with some forms of claim handling that need to go forward (i.e., normal administration of workers compensation claims). The insurer also needs to make sure the debtor remains current on its post-bankruptcy premium and reimbursement obligations. Finally, because many large insurance programs have a substantial tail, large amounts of money may be owing under the insurance program—either to the debtor or the insurer—based upon ongoing claims experience. Thus, in many cases, the insurer may be a substantial secured or unsecured creditor of the debtor, and will protect its interests accordingly. In other cases, substantial refunds may be owing to the debtor, which can fund additional distributions to other creditors.

From the perspective of the debtor's litigation opponents, the insurance issues are simple and straightforward. These stakeholders wish to verify whether any coverage is available to satisfy their claims against the debtor. Where coverage is present, they take such action as is necessary to make sure the restructuring does not impair this coverage.

Official Committees

Upon the filing of a bankruptcy case, the Office of the U.S. Trustee may determine to form a representative committee for any of these constituencies. Upon formation, such a committee would be entitled to retain counsel and other professionals, and to compensate those professionals out of the debtor's assets and revenues. Each committee would have fiduciary duties to its particular constituency and would serve as the voice of that constituency in the bankruptcy proceeding.

It is quite common for the U.S. trustee to form an unsecured creditors committee. Indeed, in a case of any size, it would be highly unusual not to have such a committee. By contrast, an equity committee will only be appointed in those cases where it is likely that the debtor's equity has positive value. Inasmuch as positive equity bankruptcy cases are not common, equity committees are likewise rare. The appointment of an equity committee is an excellent sign that there will be meaningful value in the case over which the various stakeholders can argue.

Where the circumstances warrant, committees could also be appointed for other classes of creditor or equity holders (i.e., landlords, insurers, retirees). Such additional committees are the exception and not the rule, and they arise only in those situations where the existing committees are incapable of providing adequate representation.

Trustee

In a Chapter 7 bankruptcy case, a trustee is appointed to take charge of the debtor's assets. Where a debtor has been guilty of fraud or extreme incompetence, a trustee may also be appointed in a Chapter 11 proceeding to take charge of the debtor's assets and operations. In either instance, the trustee is a fiduciary for all creditors and equity holders. In that capacity, the trustee administers the debtor's assets and operations to maximize recovery for all parties concerned. The trustee also monitors the proceeding and conducts such investigation as is needed to confirm the propriety of the bankruptcy filing. The trustee receives compensation for his or her work based upon a percentage of the total dollars in the bankruptcy case.

Office of the U.S. Trustee

The Office of the U.S. Trustee is a division of the Department of Justice charged with administrative oversight of bankruptcy proceedings throughout the country.⁴ The Office of the U.S. Trustee maintains the panel of trustees appointed to serve in bankruptcy cases. It also appears (through staff counsel) in every bankruptcy case and takes positions on such issues as may affect the viability and integrity of the bankruptcy system. Indeed, the Office of the U.S. Trustee has been described as both the "guardian" and "watchdog" of the bankruptcy system. It often focuses on the retention and compensation of professionals, the sufficiency of notice to creditors, the appointment of trustees and committees, and the structure of Chapter 11 plans. Under the recent amendments to the

⁴ The Office of the U.S. Trustee does not operate in either Alabama or North Carolina. Those jurisdictions have adopted a Bankruptcy Administrator program, which is intended to perform roughly the same functions as the Office of the U.S. Trustee.

Bankruptcy Code, the Office of the U.S. Trustee has a host of new responsibilities, including development of credit counseling programs for new debtors.

Bankruptcy Judge

Where negotiation fails, the bankruptcy judge will ultimately be required to resolve the pending disputes between the debtor and its various stakeholders. In some instances, this resolution will concern the allocation of money or property under the debtor's reorganization plan. In other cases, the judge will need to decide the amount of a claim or the validity of a lien. In still others, the judge might have to rule on whether specific operational decisions made by the debtor are in the best interests of creditors, or otherwise a proper exercise of business judgment.

Because the judge is the ultimate “decider,” he or she may truly be described as the most indispensable party to a restructuring proceeding. The judge is not dispensable, because he or she must decide every contested matter. To the contrary, in most restructuring scenarios, the parties work hard to resolve their disputes out of court. Putting aside routine motion practice, claim objections, and case administration, only the most substantial and high-stakes impasses are likely to go to full hearing and ruling. Nevertheless, the judge (or, pre-bankruptcy, the potential judge) remains a key consideration in the mind of every negotiating party. How has the judge decided this sort of issue before? What kind of hearing or trial schedule is the judge likely to set for this sort of hearing or trial? What preliminary indications has the judge given as to his or her impressions of the major issues in the case? Where the case has not yet been filed, the stakeholders will evaluate potential venues for filing based upon how various expected issues in the case have been decided in such jurisdictions. In this sense, the judge provides a sort of baseline to the negotiating parties. Each party has a sense of how the judge might rule on its issue; at the same time, most parties would not presume to have absolute confidence as to the likely ruling. These views and expectations drive the negotiating process and determine whether a settlement is likely. Where the parties value the case or the merits roughly the same way, the dispute should almost certainly be

resolved. Where the parties differ in their views of this matter, they will likely end up testing the merits before the judge.

The Decision to Restructure or Reorganize

In most instances, the decision to restructure or reorganize originates from a business or legal problem that jeopardizes the ongoing viability of the business. In some cases, this problem may be a one-time traumatic event in the life of the business. For example, a competitor may have obtained a judgment that the debtor's best-selling product infringes the patent of its major competitor. In other instances, this problem takes the initial form of a current or impending default under the credit facility. That default likely reflects underlying, substantive issues with the business. Perhaps margins have become too tight or the cost of a key expense item has spiked unexpectedly (think of crude oil and gasoline). Perhaps the debtor has over-expanded and diluted the value and quality of its product. Maybe the debtor has entered into an imprudent long-term lease or supply contract, and performance under that agreement is strangling the business.

In all of these instances, management will first make an effort to solve the problem on an operational level. The debtor's leadership must consider appropriate changes to the business plan and seek to negotiate a business resolution of the relevant problem. If the problem is essentially a two-party dispute and both sides are willing to compromise, an agreed resolution may be feasible and advantageous for both sides. If, however, the parties are at an impasse or there are multiple stakeholders with conflicting agendas, a simple business resolution may not be possible. It is at this point that the debtor may need to start considering serious structural change.

In some cases, it may make sense for the debtor to bring in an outside consulting or turnaround firm to drive the restructuring process. Indeed, some lenders may insist upon this change as a condition to further forbearance and negotiation. Whether identified internally or externally, someone will need to be designated as the chief restructuring officer. This individual then sets about identifying and developing the strategic restructuring alternatives available to the company. Such alternatives may include renegotiation of existing credit terms, a search for new debt

financing, a search for new equity, sale of specified assets or divisions, and/or renegotiation of key contracts and supply relationships. Many of these strategies also require the services of an investment banking firm to implement. These alternatives are then presented to the board of directors, which prioritizes and authorizes the actions to be taken.

If feasible, it is almost always preferable to accomplish the restructuring out of court. Bankruptcy can be expensive and uncertain. Moreover, a bankruptcy filing can sometimes depress the value of the debtor's brand, dry up its normal credit terms, and create harmful uncertainty in the marketplace. These problems can be managed, yet they are better avoided through a consensual restructuring.

So why don't all restructurings take place out of court? First, many restructurings involve multiple stakeholder constituencies, and it may be difficult to achieve such a broad range of consensus between these divergent interests outside court. Moreover, some stakeholders may have difficulty establishing consensus among their own constituents. (Think of a union communicating with its members, or an indenture trustee required to obtain 80 percent approval from its bondholders.) Finally, at the risk of stating the obvious, not all restructuring participants view the world the same way. Differing priorities and expectations of value complicate, and sometimes defeat, out-of-court restructurings.

Where a bankruptcy filing is required to implement the restructuring, this action must be properly authorized under the law of the state where the debtor is incorporated. In most instances, this authorization will be accomplished through a resolution of the debtor's board of directors. For some closely held corporations, a shareholder resolution may also be required. Where the debtor seeks to control its own restructuring, a Chapter 11 bankruptcy filing is the only realistic option. Chapter 11 permits the debtor to remain in control of its own business and operations, and to propose a plan of restructuring or liquidating its assets, liabilities, and operations. By contrast, a Chapter 7 filing amounts to a surrender—the assets are turned over to a trustee, who liquidates them for the benefit of creditors and distributes them in accordance with state laws of priority.

Upon the filing of the bankruptcy case, an automatic stay comes into effect. This stay is a broad prohibition against any effort to proceed against the debtor or its assets. Subject to certain minor exceptions, litigation against the debtor comes to a halt and parties are prohibited from interfering with the debtor's assets. Moreover, parties to leases, licenses, or contracts with the debtor are prohibited from terminating these arrangements. Simply stated, the automatic stay creates a breathing spell for the debtor to get its affairs in order.

The debtor then uses this breathing spell to stabilize its business and begin implementing the terms of its proposed restructuring. These terms are memorialized in a plan of reorganization (or liquidation) that will be reviewed and voted upon by creditors. If the plan receives sufficient support from creditors and complies with the other technical requirements of the Bankruptcy Code, it is approved by the bankruptcy judge. If the plan is rejected by creditors or otherwise judged legally insufficient, other parties may be entitled to propose a plan.⁵ Alternatively, the case may proceed to liquidation.

It is difficult to generalize about the duration and cost of bankruptcy proceedings. United Airlines incurred attorneys' fees in its Chapter 11 proceeding in the range of \$100,000,000. Smaller public companies have successfully reorganized for a fraction of that amount. Closely held companies may be able to accomplish a Chapter 11 reorganization for less than \$1,000,000. Some Chapter 11 cases take years to finish. For example, some large asbestos bankruptcies have been pending for three or four years, owing to the failure of Congress to achieve a legislative solution to the asbestos crisis and the difficulties of achieving a global valuation of the relevant asbestos liabilities. Other bankruptcies are pre-negotiated (also called "prepackaged") and can be confirmed within ninety days of the case being filed.

⁵ The debtor generally enjoys an exclusive right to propose a plan for specified periods of time. This right is one of the most important elements of a Chapter 11 proceeding, as it permits the debtor to control the case. In some cases, this right of exclusivity can be terminated prematurely.

Every stakeholder experiences some downside as a result of an extended stay in bankruptcy court. Bankruptcy increases the costs and uncertainties for all parties concerned. However, the bankruptcy filing may be unavoidable where the parties have reached an impasse, or where one of the stakeholders wishes to take advantage of certain substantive provisions of the Bankruptcy Code. United Airlines spent a lot of time and money in bankruptcy. However, United was able to use this time to good advantage by solving a number of its problems, and by substantially restructuring its business.

One of the most significant recent changes in the Bankruptcy Code imposed an outside limit of twenty months on the debtor's exclusive right to propose and confirm a plan of reorganization. Once that deadline passes, other parties will be able to propose their own alternative restructuring proposals to the other stakeholders, and the debtor will effectively have lost control of the case. As a practical matter, debtors will need to bring their cases to closure within this deadline.

Conclusion

A restructuring or bankruptcy proceeding is not a panacea. Rather, these processes represent a second chance for a debtor—an opportunity to eliminate a pressing business or legal challenge, and return focus to the debtor's core business. A successful restructuring may save the business in the sense that it forestalls the risk of immediate failure or liquidation. To truly make the restructuring a success, the debtor's leadership will need to prove they can succeed at running that core business.

Jonathan W. Young is a partner in the law firm of Wildman Harrold. A skilled and creative restructuring attorney, he is equally adept in the litigation, transactional, and counseling aspects of his practice. He regularly appears on behalf of his clients in federal, state, and bankruptcy courts throughout the country and currently serves as lead counsel to the litigation trustee appointed in the Comdisco bankruptcy cases, leading a team that has filed sixty-five lawsuits on behalf of the trustee in the federal and state courts of Illinois. He has developed substantial appellate experience, most recently winning an appeal to the Supreme Court of Alabama of a summary judgment against his client. He

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Mr. Young earned his B.A., cum laude, in 1986 from Yale University and his J.D. in 1990 from Northwestern University School of Law. He is a member of the American Bankruptcy Institute, the American Bar Association, and the Wildman Harrold diversity committee.



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