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WEATHERING THE STORM Top 10 Practical Things to Know about Bankruptcy

Bankruptcy is a highly specialized legal practice area that can be difficult for the non-lawyer to navigate. Bankruptcy can also present many traps for the unwary. A bankruptcy or distressed financial situation will in most cases materially affect a company's key relationships, customers, suppliers and business partners. All company decision makers need an understanding of how to react to protect their organization's interests. Here are ten practical considerations to recognize in this distressed environment.

- 1. Things happen fast once a bankruptcy is filed.** Financing orders can affect rights that a company's creditors have, and such orders can be entered within 48 hours after a case is filed. Creditors who receive notice of the bankruptcy financing and fail to object can have their rights subordinated or altered in materially adverse ways. Companies ignore these financing orders at their peril.
- 2. A claim that a company has against a bankruptcy debtor can lead to a significant role in a Chapter 11 case.** Creditors have an opportunity to seek to have a committee formed to represent the creditors' general interests. These "official" committees get formed early in a case. If a company is on the list of top 20 unsecured creditors, then that company might be selected to serve on the committee. Committees then select legal counsel to represent the committee, with fees and expenses being paid from the bankruptcy estate. The formation of a Creditors' Committee and the selection of counsel for a Creditors' Committee also happen early in a case.¹
- 3. Companies which owe vendors money may have other resources to pay or secure the bills.** The introduction of bankruptcy counsel to assist in assessing a company's situation may enable payment of the vendor invoices, in addition to assistance with restructuring the business. In circumstances where the representation might cease, liens on assets to secure payment may enable the vendors' bills to be paid.
- 4. Chapter 11 reorganization cases are culminated by confirmation of a "plan of reorganization."** Plans of reorganization are confirmed after a voting process that includes solicitation of votes with "proxy" type information in what is called a disclosure statement. The confirmation of a plan can potentially be *res judicata* and issue preclusive on rights or claims that a company may bring, or could have brought, in the bankruptcy case. If notice is provided to the company and rights are affected, then that creditor may be bound. Companies ignore plans at their peril.
- 5. Contracts and leases can be affected in a bankruptcy, and there are terms that can limit damages for breach in a bankruptcy.** While the liability of guarantors or other non-debtor parties to a contract might not typically be affected, there remains the potential that a plan might seek to affect these rights too.

¹ Even if not on an official committee, there are often instances where a client can band its representation with similarly situated creditors to form an "ad hoc" or unofficial committee. This strategy can be used to provide for sharing of costs while taking a meaningful role in the case to protect rights. For example, landlords might band together in a retail case.

6. **Litigation claims by or against a debtor can be affected in bankruptcy.** Cases can be stayed or removed; claims can be estimated; jury trial rights can be lost; venue can be changed; and arbitration rights can be lost. In some instances, settlement of the litigation claims can be forced despite a party's objections. Claims that are direct vs. derivative pose special problems that can affect a company's rights.
7. **"Claims" against a debtor involve an extremely broad definition--whether liquidated, unliquidated, disputed, or contingent.** All claims must be presented to the bankruptcy court by any bar date deadline or they can be lost forever.
8. **Asset sales pose opportunities for buyers and problems for companies who have property rights that might be affected by another party's bankruptcy.** These asset sales can be done quickly in bankruptcy. "Stalking horse" bidders can make provisions for payment of break-up fees to reimburse costs and expenses. Bankruptcy sales have finality, and a company's rights to challenge the sales can be quickly lost.
9. **Employment benefit plans can be altered in bankruptcy.** If a company cannot afford the benefit plan, then the plan may be rejected, which might simply result in unsecured claims that have to share in a finite asset pool.
10. **Bankruptcy can reorganize a business that needs time to adjust its model or that lacks financing to continue.** Payables can be frozen at the filing date, which creates liquidity. Cash collateral can be used with court permission to finance the business as immediate efforts are made to return the company to profitability.

For more information concerning this issue, please contact:

[Patrick L. Hughes](#)

713.547.2550

patrick.hughes@haynesboone.com

[Lenard Parkins](#)

212.659.4966

lenard.parkins@haynesboone.com

[Sue Murphy](#)

214.651.5602

sue.murphy@haynesboone.com

[Kenric Kattner](#)

713.547.2518

kenric.kattner@haynesboone.com

[Stephen Pezanosky](#)

817.347.6601

stephen.pezanosky@haynesboone.com

[Sarah Foster](#)

512.867.8412

sarah.foster@haynesboone.com

[Eric Terry](#)

210.978.7424

eric.terry@haynesboone.com