Lowenstein Sandler

Bankruptcy, Financial Reorganization & Creditors' Rights

April 1, 2020

When Financial Stress Turns to Distress–Restructuring Tools to Avoid Disaster Parts 1 and 2: Chapter 11 Checklist and What Else Is in the Toolbox

In this Client Alert series, Lowenstein's Bankruptcy, Financial Reorganization & Creditors' Rights Department will introduce the various restructuring tools available to help businesses avoid financial catastrophe in the current environment.

In addition to our recent alert providing a checklist of key steps to mitigate risk of financial distress, businesses in the myriad industries impacted by the pandemic have an assortment of tools available to help stabilize their businesses and operations and potentially avoid a financial calamity.

Chapter 11 Bankruptcy

The best-known financial restructuring tool is Chapter 11 bankruptcy, which enables businesses to restructure their debts and reorganize their businesses, or sell some or all of their assets in an orderly manner under the supervision of the Bankruptcy Court.

Chapter 11 of the United States Bankruptcy Code provides a number of valuable tools unavailable elsewhere. Advantages of Chapter 11 include:

- Protection of the automatic stay, which freezes lawsuits and other collection efforts against the company immediately when the petition is filed
- The ability to:
    - Shed burdensome contracts and leases
    - Sell valuable contracts and leases (such as below-market real estate leases)
    - Sell some or all of the debtor's assets free and clear of liens, claims, encumbrances, and other interests
- Restructuring debt consensually or over the dissent of certain creditors
- Renegotiating or rejecting labor contracts
- Restructuring or potentially shedding pension and other retirement benefits obligations
- In certain jurisdictions, and under appropriate circumstances, implementing broad liability releases in favor of officers, directors, and potentially others

Restructuring through Chapter 11 bankruptcy involves many parties. Clear communication with each of these stakeholders is crucial, as their respective motivations are inherently different.

Key Chapter 11 stakeholders typically include:

- Lenders
- Bondholders
    - Note that lenders and bondholders often have very different motivations
- Trade vendors
- Customers
- Employees
- Unions
- Pension Benefit Guaranty Corporation (PBGC)
- Landlords
- Litigation claimants
- Management

- Directors
- Shareholders
- Potential investors
- Potential exit lenders
- Prospective purchasers
- United States Trustee
  - *Arm of the U.S. Department of Justice that oversees bankruptcy proceedings*
- Creditors' Committee
  - *Appointed early in the case by the United States Trustee and acts as a fiduciary for all general unsecured creditors*

The most important conversations a potential Chapter 11 debtor may have are with its secured lenders, which (to the extent possible) should occur well before the bankruptcy filing.

Key strategic issues to consider prior to filing Chapter 11 include:

- Which creditors will be able to control the outcome of the case
- Reviewing debt documents for mistakes, omissions, lien defects, and guaranties
- Default status/negotiation of a forbearance arrangement
- Financial analysis and projections
  - Prior period actual versus budget
  - New projections
  - Recovery time—projected stabilization of the business
- Responding to the formation of ad hoc creditor groups
  - Lenders, bondholders, and trade vendors frequently organize themselves in advance of a restructuring
- Secured lender fees (make-whole payments and prepayment premiums)
- Negotiating financing for Chapter 11 including over-advances, reduced blocks, reduced reserves, use of cash collateral, and demands for additional collateral

Chapter 11 provides tools to motivate employees to remain with the business, including:

- Key Employee Incentive Program (KEIP)
  - Bonus program incentivizing management and other employees to maximize selected key performance indicators
- Key Employee Retention Program (KERP)
  - "Stay" bonus program to encourage rank-and-file employees to remain with the company
- Modified bonus arrangements for salespeople and other essential employees
- Severance plans for employees that continue until a specified event, such as a sale closing

Chapter 11 enables companies to right-size their operational footprint and related costs through:

- Closing of facilities and shedding of burdensome leases and contracts
- Managing workforce reduction
  - *Timing of notice and compliance with other regulatory requirements are crucial with respect to potential state and federal Worker Adjustment and Retraining Notification (WARN) Act and related liabilities*
- Modification of collective bargaining agreements
- Treatment of underfunded pension plans

Typical issues preceding the filing of a Chapter 11 bankruptcy case include:

- Negotiating financing with existing lenders or new lenders
  - Debtor-in-possession (DIP) financing to cover both ongoing working capital needs and Chapter 11 professional fees
- Working with vendors to continue the supply of goods and services on the same or similar terms
- Identifying "critical" vendors to be paid before (and in some circumstances, subject to Bankruptcy Court approval, after) the bankruptcy filing
  - Necessary goods and services
  - Vendors with possessory or other liens on inventory in transit or in storage
  - Foreign vendors
- Communication with key customers
- Communication programs for vendors, employees, and other key stakeholders
- Reviewing unprofitable contracts and leases
- Reviewing below-market leases for potential sale to third parties
- Selection of debtor entities in the organizational chart that require Chapter 11 protection
- Timing of filing
- Venue selection
  - Different jurisdictions treat certain important issues differently, such as third-party releases, KEIP/KERP/severance, allocation of administrative rent for midmonth filings, and timing of payment of stub rent
- Data retrieval and preservation
- Preparation of the creditor matrix

- Populating schedules of assets and liabilities
- Preparing "first day" motions (tax, insurance, cash management, critical vendor, etc.) necessary to continue operating the business in the ordinary course while in bankruptcy
- Asset sales and prepetition marketing processes
- Tax ramifications of a restructuring
  - Preservation of net operating losses and other tax attributes
  - Avoiding cancellation-of-indebtedness income

Along with the many tools available in Chapter 11 come a number of potential pitfalls warranting careful planning and strategic analysis. Lowenstein's Bankruptcy, Financial Reorganization & Creditors' Rights Department collaborates every day with businesses of all types and sizes to guide them through the bankruptcy process, from prepetition strategy, planning, and negotiations to emergence.

Other Financial Restructuring Tools

Beyond Chapter 11 bankruptcy, distressed businesses have a number of other tools at their disposal to manage and mitigate financial fallout. Some of these alternatives, which will be addressed in more detail in future Client Alerts, include:

- Out-of-court workout with lenders and other creditors
  - Consensual restructuring of debt that may include:
    - Forbearance by secured lenders/bondholders
    - Waiver of defaults
    - Extension of payment terms
    - Exchange of debt for equity or new debt
    - Collective resolution of trade debts
- Assignment for the Benefit of Creditors (ABC)
  - State law orderly liquidation proceeding
  - Conducted out of court
  - Tools and procedures differ by state
  - Fewer protections than Chapter 11
  - Less expensive than Chapter 11
- Federal or state court receivership
  - Orderly liquidation proceeding typically invoked involuntarily by creditors through judicial proceedings
- Uniform Commercial Code Article 9 secured party sale
  - Voluntary or involuntary foreclosure and sale by a secured party
- Shutdown or dissolution of a business
  - Shutting off the lights and walking away

There is no one-size-fits-all restructuring. It is important to consult with restructuring advisors (legal, financial, crisis management, tax, real estate, and others) at the earliest signs of financial distress to identify your company's best option and implement an optimal restructuring strategy.

Lowenstein Sandler's Bankruptcy, Financial Reorganization & Creditors' Rights Department will present a complimentary webinar on Chapter 11 bankruptcy and other restructuring tools in the near future. Watch for registration details and more information.

Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

KENNETH A. ROSEN
Partner
Chair, Bankruptcy, Financial Reorganization & Creditors' Rights
T: **973.597.2548**
krosen@lowenstein.com

BRUCE D. BUECHLER
Partner
Vice Chair, Bankruptcy, Financial Reorganization & Creditors' Rights
T: **973.597.2308**
bbuechler@lowenstein.com

JEFFREY COHEN
Partner
Vice Chair, Bankruptcy, Financial Reorganization & Creditors' Rights
T: **212.419.5868**
jcohen@lowenstein.com

JEFFREY D. PROL
Partner
Vice Chair, Bankruptcy, Financial Reorganization & Creditors' Rights
T: **973.597.2490**
jprol@lowenstein.com

ANDREW DAVID BEHLMANN
Partner
T: **973.597.2332**
abehlmann@lowenstein.com

ERIC CHAFETZ
Partner
T: **646.414.6886**
echafetz@lowenstein.com

JOSEPH J. DIPASQUALE
Partner
T: **973.597.2528**
jdipasquale@lowenstein.com

MICHAEL S. ETKIN
Partner
T: **973.597.2312**
metkin@lowenstein.com

ROBERT M. HIRSH
Partner
T: **212.419.5837**
rhirsh@lowenstein.com

WOJCIECH F. JUNG
Partner
T: **646.414.6862**
wjung@lowenstein.com

BRUCE S. NATHAN
Partner
T: **212.204.8686**
bnathan@lowenstein.com

MARY E. SEYMOUR
Partner
T: **973.597.2376**
mseymour@lowenstein.com