

Planning for a Chapter 11 reorganization

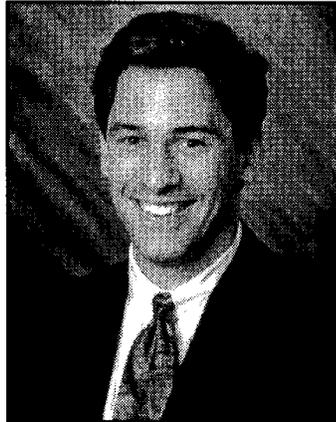
By MARTIN A. ELIOPULOS
Higgs, Fletcher & Mack LLP

In the wake of a waning economy, we are already seeing signs that it may take a while to fully recover. In the meantime, many businesses are already finding it difficult to make ends meet as a result of losing out on much needed and much relied upon revenues. Any business in this predicament will be faced with many difficult obstacles to overcome in order to keep its doors open. One of the many options to be considered in overcoming those obstacles is whether the business is a good candidate for Chapter 11 reorganization.

Although it may often appear that a Chapter 11 filing is a last resort, it is usually quite the opposite. Most Chapter 11 filings are often the result of a lengthy and carefully designed plan. Restated, a Chapter 11 debtor improves its chances of reorganizing if it has sufficient time to prepare for Chapter 11 — which it often does not.

Take the example of a small, closely held corporation with 100 creditors, 25 employees and one primary, secured lender with a blanket lien on all assets of the company. One of the first things Chapter 11 counsel will do, after conducting a conflicts check on all known creditors and employees, will be to conduct a corporate status check to make sure the corporation is in good standing and is in compliance with its bylaws and applicable state law.

Additionally, counsel will want to evaluate the strengths and weaknesses of the loan documents of the primary lender and to conduct a Uniform Commercial Code search to determine who else may be claiming liens against the debtor's assets. Finally, and most important, counsel will want to sit down with management to map out an overall game plan for reorganization and assess the debtor's business operations to confirm that it can withstand the significant cost of administering a Chapter 11 case before the case is ever filed. A Chapter 11 candidate will often, for one reason or



Martin Eliopoulos

another, be properly weeded out at this stage.

Not only is there a significant amount of due diligence to be performed by the debtor's counsel in assessing whether Chapter 11 is a viable option for a business, but there is an equal if not greater amount of work to be done to properly prepare the debtor for Chapter 11.

As little as 10 years ago, it was acceptable bankruptcy practice to throw a struggling business into bankruptcy to prevent creditors from collecting on their debts and then sort out the many bankruptcy issues after the case was pending. Today, creditors and their attorneys are more sophisticated. Often, they will be waiting at the bankruptcy courthouse steps with a handful of motions designed to end the bankruptcy before it ever gets started.

In response, Chapter 11 counsel has been forced to develop a stable of so called "first day" motions that are primarily designed to keep the creditors at bay for, at least, the beginning of the case while protecting the debtor's existing business operations.

Bankruptcy courts now expect a Chapter 11 debtor to file several motions on the first day of a Chapter 11 case including:

- A motion requesting that the debtor have permission to use the lender's cash collateral to pay the business' ordinary and necessary operating expenses;

- A motion to approve a post-petition financing arrangement with a post-petition lender to the extent that the use of cash collateral will not be sufficient to meet the debtor's cash requirements;

- A motion to provide adequate assurance of payment to the debtor's utilities;

- A complaint and a motion for injunctive relief against creditors with third-party guaranties against key nondebtor insiders who, if forced to contend with litigation on the guaranties, may lose their focus in assisting the debtor in its reorganization efforts;

- A motion to pay unpaid pre-petition wages and related expenses of certain key employees who may otherwise be forced to leave and locate more stable employment if they cannot be paid;

- A motion to pay certain critical vendors on their pre-petition claims to try to prevent them from taking their business elsewhere;

- A motion to approve compensation to any key insiders who intend to draw compensation from the debtor during the reorganization and who will likely leave the debtor if they are not compensated;

- A motion to continue to use the debtor's pre-petition bank accounts;

- A motion to limit which creditors get notice of most pleadings filed by the debtor to reduce the cost of copying and serving pleadings on creditors who will likely take no position on the pleadings served.

To properly evaluate whether Chapter 11 is going to help a business and to properly prepare for a Chapter 11 case takes time. When considering the amount of work that goes into evaluating and planning a Chapter 11 bankruptcy filing, it makes good sense to obtain competent Chapter 11 counsel at the first hint of trouble — even if it is just to confirm that Chapter 11 is not needed or will not help.

Eliopoulos is partner and chair of the bankruptcy practice group at Higgs, Fletcher & Mack LLP.