

Advanced Bankruptcy Proceedings

by Scott Graham

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Trustees responsible for collection of delinquent contributions will deal with bankruptcy often. Some of the important terms and issues that arise under Chapter 7 and Chapter 11 of the Bankruptcy Code are the automatic stay, the bankruptcy estate, liquidation and the plan of reorganization. Trustees must know their rights. Valuable information can be obtained from government Web sites.

Introduction

Trustees responsible for collecting delinquent contributions will be involved in bankruptcy court proceedings on a regular basis. This article addresses some of the important issues that arise under Chapters 7 and 11 of the Bankruptcy Code in the context of contribution collection litigation.

Typically, the contributing employer seeks protection under the Bankruptcy Code in order to stop the collection activity of its creditors and seeks either to restructure its debt or to liquidate its assets. Chapter 7 of the Code controls liquidation. Chapter 11 controls reorganization. Sometimes, the debtor proceeds under Chapter 11 of the Bankruptcy Code with an ultimate goal of conducting an orderly liquidation of assets. Regardless of what chapter the debtor initially chooses, the matter will probably end up in Chapter 7. For this reason, trustees must always evaluate whether it is appropriate to move to convert a Chapter 11 case to a Chapter 7 proceeding.

A key component of the initial filing is the bankruptcy stay. The stay acts to stop a wide variety of actions against the debtor and more importantly stops actions against the debtor's property. The stay is a powerful tool. A willful violation of the stay subjects the violator to actual damages, attorney fees, costs and even the possibility of punitive damages.

The existence of the automatic stay should not stop collection activity aimed at third parties. Specifically, construction lien claims and claims against payment bonds should move forward. In fact, when a bankruptcy petition is filed, those claims should be a top priority. Trustees should be aware that the manner in which third parties respond to these actions will determine whether they are ultimately resolved in the bankruptcy court or a different court.

The filing of the bankruptcy case creates the bankruptcy estate. The estate is generally comprised of all legal and equitable interest that the debtor has in property as of the date of filing the petition. This includes intangible rights such as intellectual property and causes of action.

Creditors seeking to collect money from the bankruptcy estate must act solely through the Bankruptcy Court. This brings together many parties with greatly divergent and competing interests, all seeking to collect a "fair" share of the debtor's property. Generally, all deserve to receive payment in full. In the case of unsecured creditors, most will receive very little, and many will receive nothing.

Bankruptcy proceedings are governed by the provisions of the Bankruptcy Code, and by the Official Bankruptcy Rules. The Federal Rules of Civil Procedure apply only as specifically adopted. Bankruptcy courts often exercise broad equitable

powers to effectuate the goals of the Bankruptcy Code.

In the context of the issues discussed here, trustees must accept the general proposition that a bankruptcy court will seek to liquidate in an orderly manner pursuant to the priority scheme contained in the Bankruptcy Code. Bankruptcy courts acting in Chapter 11 cases will seek to further the goal of allowing the debtor to continue in its business provided that creditors will receive as much in reorganization as they will in liquidation.

Unfortunately, almost all Chapter 11 cases filed by small and medium-sized businesses do not lead to successful reorganizations. Chapter 11 proceedings are expensive for the debtor. The nature of the proceeding is such that the debtor could not survive without this additional expense. It is unrealistic to think that relief provided in bankruptcy will create a likelihood of success.

It is important for trustees to understand the general nature of bankruptcy proceedings. As the competing creditors come together, they lose the right to proceed at their own pace and the range of methods to collect may be reduced. Although bankruptcy courts act often to find equity, they will not act to protect a creditor that does not act vigorously to protect itself. Therefore, trustees must know how to move quickly to protect their rights.

Although this article addresses certain specific topics, it also seeks to steer trustees to sources of information that will address all potential issues.

Government Web Sites

Valuable materials are available from government-sponsored Web sites. The sites are either free or in the case of the CM/ECF/ Pacer/Racer system, available at nominal cost (presently 7¢ per page). In order to view and print the documents, you will need to use Adobe Reader. Certain versions of this program can be downloaded on line at no cost (currently Adobe 6.0).

Official Federal Court Web Sites and Case Information

www.uscourts.gov/alllinks

This site includes links to all federal courts, including all bankruptcy courts. The individual court sites will generally include local rules that can be downloaded. It is very important to access the local rules in jurisdictions in which you work.

The individual court sites contain reference to the CM/ECF/Pacer/Racer system. The home site for this system is www.pacer.psc.uscourts.gov. The individual sites also reference the home site.

The individual court sites provide access to public documents. In order to use the system, you must establish a Pacer account. You will then receive user information that will include your individual code information. You will be billed monthly for your use.

Some courts have implemented Pacer only. Pacer allows access to a docket sheet and other important case information. However, it does not provide access to individual pleadings or documents actually filed with the court.

Where a court has implemented the Racer program, documents can be filed electronically. This occurs when hard copies are converted to a PDF format. This is done by scanning the documents and converting the image to PDF. The clerk's office will scan hard copies into the system. As a result, the images that have been scanned can be reviewed and printed.

Official Court Forms

www.uscourts.gov/bankform

This is the official site for all bank-

ruptcy forms. By accessing this site, you can download any form you will need in a bankruptcy proceeding. This will allow you to see what forms were available to a debtor and whether the debtor filed all pages of a form or schedule. In addition, the site provides instructions for the completion of most forms and some historical information in the form of committee comments.

U.S. Trustee Manuals

www.usdoj.gov/ust

The Department of Justice (DOJ) maintains a large Web site addressing many topics. This is the section of the Department of Justice site that relates to work performed by the U.S. Trustee. The site includes a number of DOJ manuals for U.S. Trustees. The documents can be downloaded.

The key benefit here is the ability to see the "how to" manuals provided to the Trustee. In addition, the information contained in the manuals is very educational.

Selected Terms

Absolute Priority: The order of payment of different classes of creditors pursuant to the provisions of the Bankruptcy Code. In theory, claims with higher priority are paid in full before lower priority claims receive anything. The usual order is first, administrative claims; second, statutory priority claims such as tax claims, rent claims, consumer deposits and unpaid wages and benefits that accrued prior to filing; third, secured creditors claims; fourth, unsecured creditors claims; and fifth, equity claims.

Administrative Claim: Generally, debt incurred by the debtor, with court approval, after the bankruptcy filing including those costs necessary to preserve the estate, as well as wages, salaries, court costs, attorney fees, accountants' fees, trustees' expenses and other necessary expenses.

Adversary Proceeding: Litigation occurring within a bankruptcy proceeding instituted in order to obtain a judicial determination of a specific contested issue. Commonly filed to determine dischargeability or priority issues, the proceeding is started with the filing of a complaint and requires responsive pleadings and resolution similar to nonbankruptcy litigation.

Bankruptcy Rules in the 7000 series apply. These rules largely track the Federal Rules of Civil Procedure.

Allowed Claim: A creditor's claim (or an equity interest) that is approved for satisfaction by the bankruptcy court under a plan of reorganization.

Asset: An economic resource or item of value owned by a business that is expected to benefit its further operations and therefore has specific value as defined by the Bankruptcy Code.

Automatic Stay: The suspension of action against the debtor. The automatic stay occurs by operation of law when a voluntary bankruptcy petition is filed, or as determined to be appropriate by the court when an involuntary petition is filed. This action protects the debtor from creditors seeking to seize the debtor's assets. The state protects some creditors in that it prevents one creditor from obtaining an excessive share of the assets of the debtor to the exclusion of other creditors.

Avoidance Power: The bankruptcy court's power to invalidate certain of the debtor's pre-petition obligations or transactions. Avoidance powers are generally intended to reverse transfers of property that favor one creditor over another.

Bankruptcy Estate: Generally, the property of the debtor that is subject to the jurisdiction of the bankruptcy court.

Bankruptcy Reform Act of 1978: First substantive Bankruptcy Code provision since the Chandler Act of 1938. The act took effect on October 1, 1979. Some of the major elements of the act were (1) modification of the Bankruptcy Court's jurisdiction; (2) authorizing joint petitions by husbands and wives; (3) consolidating various chapters into the current Chapter 11; (4) expanding the number of people eligible for the type of relief available in Chapter 13 Wage Earner Reorganization; (5) altering the appellate jurisdiction of the courts; and (6) generally making federal exemption provisions and options more expansive.

Bankruptcy Reform Act of 1994: Effective October 1994. Some provisions include (1) provisions designed to expedite bankruptcy proceedings; (2) provisions to standardize fees; (3) provisions to encourage individual debtors to use Chapter 13 to reschedule their debts rather than using Chapter 7 to liquidate; (4) provisions to aid creditors recovering claims against bankruptcy estates; (5) creation of

a national bankruptcy commission to investigate further necessary changes to the Bankruptcy Code.

Bar Date: The last date that creditors may file their claims against the bankruptcy estate.

Cash Collateral: Cash and cash equivalents held by the debtor in a Chapter 11 proceeding subject to liens by other parties.

Claims: Rights to repayment that creditors hold against the debtor. Claims may be liquidated, unliquidated, fixed, contingent, matured, unmatured, secured, unsecured, subordinated, legal or equitable.

Confirmation: The final approval by the bankruptcy court of a debtor's plan of reorganization. Confirmation takes place after the plan has been approved by creditors or after cramdown proceedings.

Core Proceedings: Those proceedings that are fundamental to the administration of a bankruptcy case. Core proceedings are subject to the jurisdiction of the bankruptcy court. Noncore proceedings may be conducted outside the jurisdiction of the bankruptcy court.

Cramdown: Confirmation of a plan of reorganization over the objections of one or more classes of creditors.

Creditors' Committee: A committee appointed by the U.S. Trustee consisting of representatives of various creditors. The committee acts on behalf of all creditors in negotiating a plan of reorganization and other major actions. There may be more than one committee.

Debtor in Possession: The debtor remaining in control of operations in a Chapter 11 proceeding.

Default: The failure of any entity or party to abide by the covenants of the debt obligation of a party. The most common default occurs when a debtor fails to pay interest or principal. The term also refers to failure to take required action in the bankruptcy proceeding itself, thereby resulting in the waiver of the right to advance a claim or a defense.

Discharge: The statement and order issued by the court eliminating debts.

Disclosure Statement: A comprehensive statement provided to creditors who are asked to vote on a plan of reorganization pursuant to Chapter 11.

Equitable Subordination: The lowering of priority of a specific claim because the court finds that the claim holder is guilty of some form of improper conduct meriting the reclassification.

Exclusivity: A debtor in Chapter 11 has the exclusive right to file a plan of reorganization during the first 120 days after the order for relief is entered. Thereafter, unless the period is extended by the court, other parties may file the organizational plans.

Executory Contract: A contract in which some or all of the obligations of each party have not yet been completed. The debtor in possession or trustee is authorized to reject unilaterally certain executory contracts.

Fraudulent Conveyance: The transfer of valuable assets from a company occurring when the company is technically insolvent, renders the company insolvent or is made for less than adequate consideration.

Impairment: The situation that occurs when a plan of reorganization alters the contractual rights of a class of claim holders. At that point, the class is deemed to be impaired. A class that is not impaired is deemed to automatically accept a plan of reorganization.

Involuntary Bankruptcy: A bankruptcy initiated by creditors holding unsecured claims.

Liquidating Reorganization: An informal term for a Chapter 11 proceeding where the company is in essence liquidating through the sale of one or more assets while it continues to operate.

Liquidation: The dissolution of a company or individual. Usually, operations seized assets are sold.

Matrix: A mailing list of creditors.

Plan of Reorganization: The document setting forth how a debtor plans to satisfy its creditors. The plan of reorganization is the cornerstone of a Chapter 11 proceeding.

Preference: A payment by a debtor made during the 90 days preceding the filing of a bankruptcy petition, and during one year if the payment is made to or on behalf of an insider. Preference payments can usually be recovered and paid into the bankruptcy estate.

Proof of Claim: Form filed by a creditor setting forth its claims against a debtor.

Receiver: A person appointed to take control of the debtor's property.

Secured Creditors: One of the two general types of creditors of the company. Secured creditors have a lien on property of the debtor.

Skeleton Filing: The term used to describe a bankruptcy filing in which not all necessary and proper forms have been filed. Certain courts allow a case to commence only if certain important forms are filed so long as the balance of the required forms are filed within a specific period of time.

Super Priority Claim: An administrative claim that will be paid ahead of other administrative and priority claims.

Trustee: An agent of the court who manages the property of the debtor for the benefit of creditors. This type of trustee should be distinguished from the U.S. Trustee, who plays an administrative role in all bankruptcy cases.

U.S. Trustee: The person who acts as an agent of the United States Department of Justice in order to assist in bankruptcy cases. The U.S. Trustee administers many of the duties of the court including appointing committees, appointing trustees and examiners, reviewing documents, etc.

Unsecured Creditor: One of two general types of creditors. Unsecured creditors have no liens on the debtor's property.

Creditors' Meetings and Committees

Section 1102 of the Code directs and authorizes the U.S. Trustee to appoint an official committee of unsecured creditors (creditors' committee). Benefit and welfare plans are eligible to sit on a committee. (See: *In re Barney's Inc.*, 197 B.R. 431 (Bankr. S.D.N.Y. 1996); *In re Enduro Stainless, Inc.*, 59 B.R. 603 (Bankr. N.D. Ohio 1986).)

The committee is normally appointed very soon after a petition is filed, often before the first meeting of creditors. The committee will be comprised of persons whose claims are impaired.

The Trustee has the authority to appoint additional committees, but this will not generally happen unless the case is very large. Tension among creditors is unavoidable. This alone, or the potential for conflict, is not enough to require the appointment of additional committees.

It is crucial to prudently limit administrative expenses. Multiple committees are proper only when conflicts are so serious that it makes it difficult for the committee to properly function. In small business cases (as defined by 11 U.S.C. §101 (51C)),

the court may, for cause, order that a committee will not be appointed.

The Trustee should use the debtor's list of 20 largest unsecured creditors to make preliminary contact with creditors. The Trustee may hold an organizational meeting in order to learn more about the debt structure involved and to gather information to be used to appoint a committee.

In large cases, the Trustee may distribute an informational questionnaire. The purpose is to gather information that will allow the Trustee to evaluate whether a creditor should be included on the committee.

The Trustee will appoint a committee based on the information provided. If your interest is entitled to priority treatment under §507(a)(3) and (4), don't expect appointment because of the conflict that exists with unsecured creditors. The mere fact that a claim is disputed does not disqualify the creditor from the committee.

A committee may be appointed in an involuntary case, but not until the entry of an order for relief. (11 U.S.C. §1102(a)(1))

The initial meeting of creditors occurs

20-40 days after the petition is filed. The U.S. Trustee presides. The meeting is open to any creditor. The debtor is questioned under oath. Questioning is generally limited, and more detailed questioning is available in a Rule 2004 Examination.

The committee power is:

- Investigate assets, liabilities and debtor conduct.
- Negotiate plans of reorganization.
- Hire professionals (cost is an administrative expense to the estate).
- Demand and receive regular reports from the debtor.

The practical benefits of a committee are:

- Better access to information and an

inside track to what is happening in the case

- A chance to participate in Chapter 11 negotiations with the debtor
- Always keep the best possible notes of all meetings that you attend. Keep these in a separate file.

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For information on ordering the book or reprints of this article, call (888) 334-3327, option 4.

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