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INTRODUCTION TO CHAPTER 11 BANKRUPTCY

With

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And

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Program description

If you are an attorney looking to expand into doing bankruptcy work, you must watch this 1.0 credit CLE program. Representing an entity filing for Chapter 11 is not something to be taken lightly; this discussion offers a frank view of what bankruptcy attorneys must know to help their clients.

I. Introduction

- **Practicing since 1977; office phone 609-259-1122**
- **Always deeply involved with bankruptcy – consumer and business**
- **Got started in bankruptcy because economy changed – people involved in real estate deals were having problems, bought too many properties, bought more than they could chew**
- **2008 or before – people acquiring properties during this time period**
- **Leveraging one property to buy the next property but did not work out because property values dropped**
- **Property owners concerned about what to do – viable alternative was reorganization**
- **Average client was an individual who owned income property - multi family dwelling, strip malls, multi use buildings**
- **Most of the clients were LLCs for the particular entity – trying to isolate the property and themselves by creating LLCs**
- **LLCs were single member LLCs – taxed as if sole proprietorship**
- **Triggering event for commercial property owners to seek bankruptcy – cash flow that expected was not sustained to keep property above water, refinanced other properties to sustain another property, then realized that it was not good idea and created a bigger problem**
- **Each debtor is in a different situation**
- **Property prices either stabilize or drop and mortgage goes up, property owners are living near the edge in cash flow not putting away reserves – not far to go to realize in trouble**
- **Could attorney recommend to client in this position to take money from other sources to stay out of bankruptcy? – not a good idea – need a great deal of cash down and analyze your investment – in today's economy banks want 25-30% down – in 2008 10% was required**
- **LLC with property that is highly leveraged, property underwater, no tenant**

II. How does an LLC qualify for Chapter 11

- **To reorganize a business that is an corporation can only have a reorganized liquidation – prospective buyer – have 363 sale**
- **Certain business organizations that are eligible for Chapter 11 – S corporation, individual, LLC, C corporation, partnership, LLP**

- **Disregarded entity – from tax purposes you are not taxed as a corporation**
- **Chapter 11 vs. Chapter 13 = 11 USC §109, Who may be a debtor**
 - **Delineation based on monetary valuation – secured and unsecured debt**
- **Chapter 13 – preference – limit the number of people who can file for this; easier to do Chapter 13 than Chapter 7 if the person has the means to do so; “means test” dictates whether you qualify for Chapter 7 – if you are above certain income limits, then you must file Chapter 13; although exceptions, means test allows to qualify for 7 depending on expenses**
- **Vast majority of individuals – Chapter 13 is the only option – Congress wants individuals to pay something back – so able to discharge certain debt**
- **11 USC §1328 – Discharge**
- **Certain persons are limited and can only apply for Chapter 11 – limitations for individual are \$1.4M in secured debts and \$369000 in unsecured debts (these numbers are higher now)**
- **Secured debt = car loans, mortgages, UCC filed against property**
- **Judgment creditor can elevate status over 90 days to change character of classification from unsecured to secured**
- **Chapter 11 is more expensive than Chapter 13 to file – staying in Chapter 13 is more reasonable**

III. Chapter 11 for people in business

- **Commercial income property owner**
- **If really are intent on saving property and reorganizing, can file Chapter 11**
- **3 types of Chapter 11:**
 - **Most restricted type – single asset real estate case – investor bought 1 property, not a separate business doing other things, real estate put into bankruptcy – 90 days exclusivity period during which a debtor can follow a plan**
 - **Small business case – have under \$2.3M in debts - 180 days exclusivity period during which a debtor can follow a plan**
 - **Conventional – 120 days exclusivity period during which a debtor can follow a plan**
- **When debtor comes to attorney and thinking Chapter 11**
 - **What is their objective?**
 - **Must deal with reality as opposed to emotions of clients**

- **Bankruptcy inherently has emotional issues**
- **Chapter 11 is like a failure (bad luck, economy, etc)**

IV. Attorney obligations

- **Let them know alternatives and client chooses what to do**
- **Leave it to the client**
- **Indicate risks and protect yourself as an attorney by writing down legal advice even if clients do not take it**

V. Single Asset Real Estate Case

- **If you want to save the property – make it work**
- **Get rid of expenses to save the business**
 - **Principal is more than value of the building**
 - **Can “cram down” value of the building – change value to what the value of the asset is – if loan is higher than value, then amount above value is unsecured debt**
 - **If change principal balance and change interest rate to prime rate (Till v. SCS Credit Corp, 541 US 465 (2004)) – then may give client opportunity to have income from property actually pay the debt**
 - **Cram down applications are hotly contested – part of a plan**
- **File Chapter 11 petition and automatic stay is in place for debt collection**
- **90 days to develop a plan**
- **Plan would make situation that is viable so that property can sustain itself and pay off debts**
- **Priority debts are real estate taxes and need to maintain property (generate rents)**
- **1st day motions – you have a mortgage and have special assignment of rents to indicate the rents are lender’s property so that debt can be paid; file this motion to utilize those rents as the debtor’s property – make agreement with the bank; can use this motion to continue to pay wages, rents and other debt – need court’s permission to pay even pre-petition wages**
- **Whether just principal or with interest – depends on the property**
- **Employee debts are priority debts, i.e. wages, medical insurance, pensions, etc.**
- **Trustee has a right to void contracts – the code deals with these issues**
- **What debts would be liquidated as part of the plan?**

- **Different priorities of debts**
- **Unsecured debts – lowest class of debt, least secured and least likely to be paid**
- **Must satisfy that creditors in Chapter 11 would do better in Chapter 11 than in Chapter 7 – need incentive**
- **If person makes a purchase within 90 days of filing – can be considered purchased in anticipation of bankruptcy – may not be able to keep what you purchased**
- **Priority unsecured debts**
 - **11 USC 507 Priorities**
 - **Withholding taxes, corporate taxes, etc. – must be paid within 60 months as filing of petition**
 - **Sales taxes**
 - **60 month period can be extended**
- **Property taxes follow the property and not the individual but if doing a single asset then need to address this to keep the asset**
- **In Chapter 7 – there are instances to allow for taxes to be forgiven**
- **Secured debt (mortgage, judgment debtors, etc.) – depends on what they are secured by – can be crammed down**
- **11 USC 522 exemption**
- **No trustee in Chapter 11 unless US trustee's office moves to appoint one**
- **The petitioner is the trustee in a Chapter 11 case**
- **To renegotiate with bank to get interest rate – just call mortgage company because able to change some contract terms – in Chapter 11**
- **Need to demonstrate that secured debts are properly protected**
- **Not supposed to accrue additional debt after file petition**
- **If you have a car loan, need to prove there is insurance – make sure loan is properly protected**
- **Must demonstrate income coming in can pay for debt**
- **1st day motions must be addressed right away, i.e. maintain utility services (11 USC 366 Utility Service), so that you can operate going forward**
- **Banks are realistic and have counsel to make sure they are protected**
- **Most banks will work with debtor**
- **People make a bona fide effort to make a business work – put so much money in that they are getting over their head**
- **Most debtors want to avoid bankruptcy**

- **85-90% have a plan that works – 60 month plans**
- **Chapter 13s are pretty successful**
- **Bankruptcy court has a program that allows debtor to work out mortgage modification in the bankruptcy court and making certain payments while submitting documents (Chapter 7, 13 and 11)**
- **People have a good business idea but don't know how to run a business**
- **Conversion to Chapter 7 when in the middle of Chapter 11**
 - **Can petition for conversation**
 - **Trustees office can convert**
 - **Can have a confirmed plan that is modified if it is not working**
 - **Priority debtor would move to vacate the stay – not likely to apply for conversion**
- **No limitations as to how many Chapter 11 filings can occur – individuals in Chapter 11 can get discharges but no such thing for corporations**

VI. Chapter 12 – farm land bankruptcy

- **Special because must be qualified as farmer or fisherman**
- **Don't need to own farm just need to lease it – or lease a fishing boat**

VII. Small business case – debts of less than \$2.3M

- **Extra time to create a plan**
- **Wanted to afford quicker process to small business**
- **File disclosure statement and plan can get quicker approval**
- **Streamlined process**
- **Process the same as conventional Chapter 11**
 - **Open DIP account**
 - **Insurance**
 - **Abide by operating guidelines from US Trustee's Office**
 - **Meet with creditors**
 - **Operating reports need to be filed monthly**
 - **Demonstrate viable operating entity**
- **A great deal of work needs to be done from the beginning – know what you are facing**
 - **UCC issues?**
 - **Assignments of rents**

- **Judgments client does not know about**
- **Do your due diligence – know where you are headed**
- **Work with an accountant who knows how to do these things – forensic accountant – must know reporting requirements, set up debtors properly, following guidelines**
- **Need a good team working with you professional to get the job accomplished for clients**

VIII. Preferential transfers

- **May want to set aside transaction within 90 days prior to filing to gain assets back**
- **Insider must file within a year**

IX. Fraud

- **When an attorney discovers that there is fraud perpetrated, can place attorney in adversarial position with the client**

X. Conventional Chapter 11/Big corporations

- **Legal fees are enormous because of complexity of the case**
- **Get approval for every penny of fees**
- **Must be appointed as counsel and then fees get approved**
- **Fee is administrative – get preference**

XI. Legal fees

- **\$300+ per hour**
- **\$5-10K depending on complexity**
- **Single asset – reasonable fee would be \$10K, many hours of time (53-60 hours) to prepare a plan**
- **Get substantial retainer up front but cannot always do that**
- **Small business case - \$30-40K depending on complexity**
- **Reasonableness of fees is decided by the court**
- **Courts are realistic in viewing the billing by attorneys**
- **Make sure you get an adequate legal fee – lots of detailed work to prepare to file petition and advise the client of realistic outcome; need a good team**
- **Appraisers and other experts must be approved and qualified for specific requirements of each case**

XII. Words of advice

- **Be careful**

- **Satisfaction of saving a business or family**
- **Chapter 11s have slowed down**
- **Bankruptcies are on the increase – mostly unemployment**