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# What Commercial Litigators and their Clients Need to Know about Bankruptcy

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# About Practical Law

- Practical resources covering all major practice areas.
- Overviews, model documents, trend articles and more created by our expert attorneys.
- Dedicated areas for law firms, law departments and law schools.
- Practice centers for specialists
- What's Market for commercial agreements.
- Updates on the latest legal and market developments.
- *Practical Law The Journal* magazine covering today's transactional and compliance topics as well as key issues and developments in litigation practice and procedure.

The screenshot displays the Practical Law website interface. At the top, there is a navigation bar with a 'US' dropdown menu, a 'Change country' link, and a 'Log out' button. The main header features the 'Practical Law' logo with the tagline 'A THOMSON REUTERS LEGAL SOLUTION', followed by navigation links for 'Practice Areas', 'Resources', 'International', and 'My Practical Law'. A search bar is located below the header, with 'All US' selected in the dropdown and a search icon on the right.

The main content area is titled 'Practical Law for Law Firms'. It features a 'Practice Areas' section with a grid of links: Antitrust, Arbitration: International, Bankruptcy, Capital Markets & Securities, Commercial, Corporate and M&A, Employee Benefits & Executive Compensation, Finance, Intellectual Property & Technology, Labor & Employment, Litigation: Federal, Real Estate, and Tax. To the right of this grid is a 'What Are You Working On?' box with a 'Get Started Now' button.

Below the grid, there are three sections: 'What's Market' (with a 'Get up to speed on the latest deals, agreements and filings.' and a 'All What's Market' link), 'State Q&A' (with a 'Review and compare state law across multiple practice areas.' and a 'All State Q&A' link), and 'Featured Updates' (with an 'All updates' link). The 'Featured Updates' section contains three articles: 'The Letter of Intent for BlackBerry: Desperate Times, Desperate Measures' (dated September 26, 2013), 'What's Market Public Merger Activity for the Week Ending September 27, 2013' (dated September 26, 2013), and 'In re Kenneth Cole: New York Court Dismisses Challenge to Going-private Transaction' (dated September 24, 2013).

At the bottom right, there is a 'Meet the Team' section featuring a profile for 'Lawrence Hsieh Commercial' and a 'Meet Our Experts' button. Below that is a 'The New Practical Law' section with a 'Learn More' button.

## Types of Bankruptcies

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- Chapter 7 – Liquidation
- Chapter 11 – Individual or corporate reorganization
- Chapter 13 – Individual reorganization
- Chapter 9 – Municipalities
- Chapter 12 – Family farmer or family fisherman reorganization
- Chapter 15 – Cross-border cases

# The Players

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- Debtor; Debtor in Possession (DIP)
  - Remains in control in a Chapter 11 case
- Chapter 11 Trustee
  - Obtains power to operate the debtor's business (in place of the DIP)
  - Appointed only in extreme cases upon a showing of fraud, dishonesty, incompetence, or gross mismanagement

## The Players (cont.)

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- U.S. Trustee
  - Division of the Department of Justice
  - Oversees the bankruptcy system
  - Appoints and supervises other trustees
  - Appoints official committees
  - Reviews applications to employ and compensate professionals
  - Investigates bankruptcy fraud and abuse
  - Monitors case progress

## The Players (cont.)

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- Professionals
  - Trustee or DIP may hire professionals to perform services
    - Attorneys, accountants, auctioneers, appraisers, investment bankers, consultants
    - Professional must be a “disinterested person” with no interest adverse to the estate
  - Employment and compensation of professionals is subject to bankruptcy-court approval
  - Creditors’ Committees can also employ professionals

## The Players (cont.)

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- Chapter 7 Trustee
  - Automatically appointed upon the filing of a Chapter 7
- Standing Trustee
  - Appointed in Chapter 12 and 13 cases to collect and distribute the debtor's earnings under a plan
- Examiner
  - May be appointed to investigate charges of fraud, dishonesty, incompetence, or mismanagement by debtor's current or former management

## The Players (cont.)

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- Unsecured Creditors' Committee (UCC)
  - Large Chapter 11 cases; sometimes in large Chapter 7 cases
  - Usually consists of 5 to 7 largest unsecured creditors willing to serve
  - Represents the interests of all unsecured creditors, not individual interests
  - Debtor's estate pays for counsel for the UCC (sometimes also financial advisors and other professionals)
- Other committees can be appointed



## Chapter 7 Bankruptcy

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- Individuals and corporations
- Can be commenced by
  - Voluntary petition filed by debtor; or
  - Involuntary petition filed by creditors
- Chapter 7 Trustee is automatically appointed
  - Investigates the debtor's financial affairs
  - Paid a percentage of funds distributed

## Chapter 9 Bankruptcy

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- Adjustment of Debts of Municipality
- A municipality may only file if
  - State law permits the filing; and
  - It is “insolvent”— generally not paying debts as they become due.
- Includes an *automatic stay*
- Debtor has the exclusive right to propose a plan
- Debtor can reject or assume executory contracts
- The bankruptcy court’s power to oversee a Chapter 9 debtor’s affairs is more limited than in Chapter 11

## Chapter 11 Bankruptcy

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- Who can be a Chapter 11 debtor?
  - Corporations, partnerships, and LLCs
  - Foreign companies with assets in U.S. recognized under Chapter 15
  - Individuals
    - Fail the Chapter 7 means test and exceed the Chapter 13 debt limit

## Chapter 11 Filing

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- Estate created consisting of all of debtor's assets, including causes of action
- Existing management continues to operate the business (DIP)

## Chapter 13 Bankruptcy

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- Relief for an individual debtor
  - With “regular income” as of the petition date; and
  - Owes no more than \$383,175 in unsecured debts and \$1,149,525 in secured debts
  - Debtor retains assets it would otherwise give up in a Chapter 7
- Debtor uses his income, after essential expenses, to pay off a portion of debts over 3 to 5 years
  - A standing trustee is appointed to administer the case

## Chapter 15 Bankruptcy

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- Transnational Bankruptcy Cases
  - Generally the Chapter 15 case in the U.S. is ancillary to a primary proceeding in another country
  - Alternatively, if the U.S. assets are sufficiently complex, the foreign debtor or a creditor may commence a full Chapter 7 or Chapter 11 in the U.S.

# Bankruptcy Court Jurisdiction

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- 28 U.S.C. §1334(a) vests the district court with original and exclusive jurisdiction of bankruptcy cases
- 28 U.S.C. §1334(b) vests the district court with original but not exclusive jurisdiction of civil proceedings
  - “Arising under” the Bankruptcy Code
  - “Arising in” a case under the Bankruptcy Code
  - “Related to” a case under the Bankruptcy Code

## Bankruptcy Court Jurisdiction (cont.)

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- Core matters: integrally related to a bankruptcy case; listed in 28 U.S.C. § 157(b)
- Non-core matters – cannot enter final orders without parties' consent
- *Stern v. Marshall*, 131 S. Ct. 2594 (2011)



## Jury Trial Rights

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- Bankruptcy courts can conduct jury trials
  - Must be specifically designated by the district court; and
  - The parties must consent
- Most district courts have designated bankruptcy courts to conduct jury trials when the parties consent.
- A party that files a proof of claim loses jury-trial right. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989) (fraudulent transfer litigation); *Lagenkamp v. Culp*, 498 U.S. 42 (1990) (preference litigation).

## Voluntary versus Involuntary Filings

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- Voluntary petition filed by debtor (authorized by board of directors)
  - Debtor is not required to be insolvent
  - The only requirement is that the debtor seeks relief from creditors in good faith

## Voluntary versus Involuntary Filings (cont.)

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- Involuntary petition filed by creditors
  - If the debtor has more than 12 unsecured creditors
    - Petition must be filed by at least three unsecured (or undersecured creditors); and
    - Filing creditors' noncontingent, undisputed claims must total at least \$14,425 in unsecured claims
  - If fewer than 12 unsecured creditors
    - One holder of an unsecured claim of at least \$14,425 may file
    - Two creditors may join to satisfy the \$14,425 requirement
  - Proceed cautiously!
  - If the court dismisses the filing, the debtor may be able to recover attorneys' fees and damages.
  - If filing was in "bad faith," the debtor may be entitled to punitive damages.

## Automatic Stay

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- Filing of voluntary or involuntary petition triggers the *automatic stay*
- Breathing spell for the debtor
- Stops nearly all acts and proceedings against the debtor and its property. For example:
  - Filing a lawsuit, continuing to litigate, enforcing a judgment
  - Informal and formal collection actions
  - Acts to create, perfect, or enforce liens
  - Eviction and foreclosure actions and lease termination
  - Exercising a setoff right (an administrative freeze may be permissible)

## Automatic Stay (cont.)

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- Automatic stay generally applies only to the debtor and its property
- It generally does not extend to
  - Third Parties
    - Debtor’s guarantors, co-debtors, officers and principals, co-defendants, or partners
    - Limited exceptions where claim against non-debtor will seriously impact the debtor
  - “Administrative freeze,” including to preserve a setoff right
  - Recoupment
  - Proceedings brought by the debtor

## Automatic Stay (cont.)

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- Action taken in violation of the automatic stay is void or voidable
- 28 exceptions identified in 28 U.S.C. § 362(b)
- Willful violation of the stay
  - Injured party entitled to actual damages, including attorney's fees, and punitive damages, if appropriate
- Innocent violations are punishable

## Automatic Stay (cont.)

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- Pending litigation
  - Non-debtor party to litigation should notify the court of filing
- Stay terminates when property is no longer property of the estate
- Bankruptcy Abuse Provisions and Consumer Protection Act (BAPCPA) of 2005 additions:
  - If the debtor had dismissed a filing within the prior year, then the stay is limited to 30 days, unless debtor shows second case filed in good faith
  - If the debtor had two dismissed filings within the prior year, then there is no stay

# Grounds for Relief from Automatic Stay

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- “For Cause” – not defined in the Bankruptcy Code
- Examples:
  - Allowing tort claimants to obtain a determination of liability
  - Lack of adequate protection
    - Secured creditors are entitled to protection against actual or threatened diminution in the value of their collateral
      - E.g., periodic cash payments; additional or replacement liens
  - Debtor has no equity in property and property is not necessary to effective reorganization



## Grounds for Relief from Stay (cont.)

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- Single-asset real estate
  - Secured creditor may foreclose unless within 90 days:
    1. Debtor files a plan with a reasonable possibility of being confirmed in a reasonable time; **OR**
    2. Debtor starts paying monthly interest payments
- Acts against real estate
  - Eviction, foreclosure, etc., may not be stayed if
    - The case was filed as “part of a scheme to delay, hinder, and defraud creditors” either by multiple bankruptcy filings, or by transferring an interest in the property without secured creditor’s or court’s consent

## Discharge and Dischargeable Debt

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- Discharge (corporations do not get a discharge in Chapter 7)
- In Chapter 7 cases, upon order of the court (11 U.S.C. § 727)
- In Chapter 11 cases, upon confirmation of a plan (other than through a liquidating plan) (11 U.S.C. §1141(d))

## Common Exceptions to Discharge

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- Certain taxes
- Debts incurred fraudulently
- Debts not listed in time to permit a creditor to file a proof of claim
- Domestic support obligations (typically child support or maintenance/alimony)
- Debts incurred through willful and malicious injury to another person or another person's property (Does not include negligence)
- Fines owed to a governmental unit
- Most student loans
- For death or injury caused by the debtor's intoxicated use of a motor vehicle

## Objections to Discharge

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- May object to discharge generally or to discharge of a particular debt
- To object in Chapter 7 and 13 cases, an adversary proceeding complaint must be filed within 60 days after the first date set for the meeting of creditors (Fed. R. Bankr. P. 4004(a), (c)).

# Federal Rules of Bankruptcy Procedure

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- FRBP apply; not FRCP
- Many of the FRBP applicable to adversary proceedings simply incorporate the FRCP
- Many of the FRBP that apply to adversary proceedings apply to contested matters
- Bankruptcy appeals are governed by FRBP 8001, *et seq.*
  - 14 days to file a notice of appeal
- Federal Rules of Evidence apply in bankruptcy cases

## Local Bankruptcy Rules

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- E.D. Mich. LBR 9014-1: 14 days to respond to motions
  - Generally no hearing if no response
- E.D. Mich. LBR 7026-3: no discovery in contested matters without leave of court

## Service and Noticing

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- Debtor upon filing petition provides notice to list of creditors (the “matrix”)
- Only certain matters need be noticed to the entire matrix
- FRBP 7004 incorporates most of FRCP 4
  - Also provides for nationwide service via first class mail
- Answers to complaints are due within 30 days **of issuance of the summons**
  - A summons must be served within 14 days

# Proofs of Claim

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- Chapter 7
  - A proof of claim (POC) must be filed
- Chapter 11
  - If a claim is scheduled, a creditor need not file a POC unless it disagrees with the amount or the claim is listed as disputed, contingent, or unliquidated
- Chapter 13
  - A POC must be filed
- Filing a POC = consent to bankruptcy-court jurisdiction and relinquishment of jury-trial right



## Bankruptcy Discovery

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- Rule 2004 – Governs discovery in the bankruptcy case (“Rule 2004 Exam”)
  - Commonly used for pre-filing discovery
  - Scope of Rule 2004 exam is extremely broad (“fishing expedition”)
  - Upon initiation of an adversary proceeding or contested matter, discovery is governed by FRBP 26, *et seq.* (which largely incorporates the FRCP)
- First meeting of creditors
  - Opportunity to question the debtor

## Withdrawal of the Reference

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- Bankruptcy jurisdiction is vested in district courts
  - District courts typically refer cases to the bankruptcy courts by local rule
- District courts may withdraw the reference in whole or in part
  - Mandatory withdrawal: resolution requires consideration of both bankruptcy law and “other laws of the United States regulating organizations or activities affecting interstate commerce.”
  - Discretionary withdrawal: for cause shown

## Withdrawal of the Reference (cont.)

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- Motion to withdraw the reference
  - Filed in bankruptcy court, determined by district court
- Timeliness
  - Rules set no deadline, so check local rules
  - Some local rules, for example, require filing it simultaneously with a jury demand
- Withdrawal may be immediate or when proceeding is ready for trial

# Removal and Remand

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- Removal can be based on bankruptcy-court jurisdiction
- One party can remove
- Can remove the entire case or one claim
- Removal is to the district where the underlying proceeding is pending
  - Most district courts have a local rule that the removal is filed in the bankruptcy court
- Timeliness
  - Pending litigation: longest of 90 days after order for relief or 30 days after entry of an order terminating a stay
  - New Actions: 30 days after receipt of the summons or initial pleading

## Removal and Remand (cont.)

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- Removed cases may be remanded on any equitable grounds
- Mandatory Abstention
- Discretionary Abstention

## CLE Credit

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- CLE credit (1.0 General Credit) is available in *AL, AK, AR, AZ, CA, CO, GA, HI, IA, IL, ME, MN, MO, MS, MT, ND, NH, NJ, NY, OK, PA, TN, TX and VT.*
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- Please send any questions to [PLwebinars@practicallaw.com](mailto:PLwebinars@practicallaw.com)

# Questions

# Relevant Practical Law Resources Available with a *Free Trial* to Practical Law

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- [Bankruptcy Basics: What Commercial Litigators Need to Know](#)
- [Bankruptcy: Overview](#)
- [Bankruptcy: Overview of the Chapter 11 Process](#)
- [Fraudulent Conveyances in Bankruptcy: Overview](#)
- [Automatic Stay: Lenders' Perspective](#)
- [Filing a Proof of Claim in a Chapter 11 Bankruptcy Case](#)
- [Preferential Transfers: Overview and Strategies for Lenders and Other Creditors](#)



# About the Speakers

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Ms. Calton successfully counsels banks, finance companies, manufacturers and other business clients in commercial law, corporate reorganization and transactions.

- Represents clients in negotiations, disputes and in insolvency and bankruptcy-related litigation
- Possesses extensive preference litigation experience
- Well versed in forming and leading joint national defense groups for multiple preference or actions in Michigan, New York and Delaware bankruptcy courts
- Recognized as having particular knowledge on rules of procedure, testifying twice before the Judicial Conference Advisory Committee on Bankruptcy Rules, Civil Rules and Evidence Rules, writing commentary on the proposed amendments to the Federal Rules of Bankruptcy Procedure on behalf of the Bankruptcy Advisory Committee and other Bar groups
- Reporter for a subcommittee of the Advisory Committee drafting new local rules for Chapter 11 cases, amending the local rules in 2007 and to be effective December 1, 2009. She was also the reporter for a committee advising the Michigan Legislature on amending the state exemptions, which amendments were adopted into law.

# About the Speakers

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Dan concentrates his practice on litigating and resolving commercial, contract and bankruptcy disputes. He has tried and arbitrated several cases and has significant experience negotiating the settlement of complex matters. Dan collaborates with clients to evaluate business and legal options to efficiently resolve disputes both before and during the litigation process.

- Manages and litigates supply-chain disputes, including pricing, requirements contract, adequate assurance of performance, termination for convenience, tooling and mold lien, claim and delivery (replevin), specific performance and injunctive relief matters
- Represents creditors in bankruptcy proceedings, including executory contract, automatic stay, fraudulent transfer, preference, denial of discharge, recoupment and setoff and claim objection litigation
- Negotiates and drafts supply and development agreements (including video game development agreements) to address payment, revenue, intellectual property, deliverable, and project scope and timing issues
- Serves as a member of the firm's Automotive and Social, Mobile and Emerging Media Industry Groups