

Lecture 10 (Notes by Leora Schiff)

15.649 - The Law of Mergers and Acquisitions (Spring 2003) - Prof. John Akula

Bankruptcy Law

- I. Chapter 7 – liquidation
- II. Chapter 11 – reorganization
 - a. Advantages
 - i. Automatic stay –
 1. prevents creditors from pursuing debt collection
 2. only have to continue to pay secured debt
 - ii. Protection from lawsuit
 - iii. Get out of bad contracts
 1. Kmart and leases – able to reject leases
 2. American Airlines – threatening to get labor contract rejected
 - b. Disadvantages
 - i. Full financial disclosure
 - c. UCC filing
 - i. Uniform Commercial Code Article 9 –
 1. scheme for secured transactions
 2. rights of secured party as against other creditors of debtor
 3. creditor can perfect its security interest by
 - a. filing a CUU-1 Financial Statement.
 - b. By possession of collateral
 - c. By control
 - ii. Secured creditor can have lien placed on debtor's assets
 - iii. No lender can “prime” a properly filed UCC
 - d. Involuntary bankruptcy
 - i. Requires 3 creditors to file
 - ii. Secured creditors wouldn't do – can get collateral
 - e. Priority of Distribution
 - i. Secured creditors
 1. continue to be paid while company is in bankruptcy
 2. oversecured (collateral worth more than debt); undersecured (worth less)
 3. can ask for relief by getting collateral
 - ii. Administrative fees for bankruptcy actions – legal
 1. cost is huge
 - iii. Priority creditors
 1. wage claims
 2. taxes

- iv. Unsecured – trade debt
- v. Bond holders
- vi. Equity
- f. Debtor in possession – DIP
 - i. Can find new lender to provide funds to survive
 - 1. superpriority position over other debtors –
 - a. requires approval bankruptcy courts
 - b. lien only on assets purchased after Chapter 11
- g. Out of court workouts – negotiate with creditors to stave off bankruptcy
- h. Preferences and Fraudulent Transfer Claims
 - i. Payments made to unsecured creditors within 90 days of going insolvent on pre-existing debt
 - ii. Creditor can be sued to return payment
- i. Bankruptcy auctions - Liquidating under Chapter 11
 - i. can get company better deals – going concern
 - ii. more control over auction process

III. Reorganization process

- a. Plan of Reorganization
 - i. Contract between creditors and debtor – dictates how pre-petition debt will be repaid
 - ii. Broken down into classes
 - 1. administrative
 - 2. secured
 - 3. trade
 - 4. impaired – class will not receive all of its state-law rights (ex. Terms of repayment changed by the plan)
 - iii. unasserted claims
 - 1. Proof of claim – creditor files with court what's owed
 - 2. if creditor doesn't file proof of claim, claim can be barred
 - iv. Creditors Committee
 - 1. committee of unsecured creditors
 - 2. 2/3 of \$ amount and majority of number of creditors voting need to vote to approve
 - 3. debtors need impaired class to vote in favor
 - a. if can get 1 impaired class that votes in favor, courts can cram down other impaired classes
- b. Disclosure Statement
 - i. Document like prospectus
 - 1. Business under bankruptcy
 - 2. Projections

- c. Plan and disclosure statement filed at same time – both need to be accepted
 - i. Once court approves, sent to creditors for a vote
 - ii. Exclusivity period – 120 days post bankruptcy filing during which debtor has exclusive right to propose plan of reorganization