



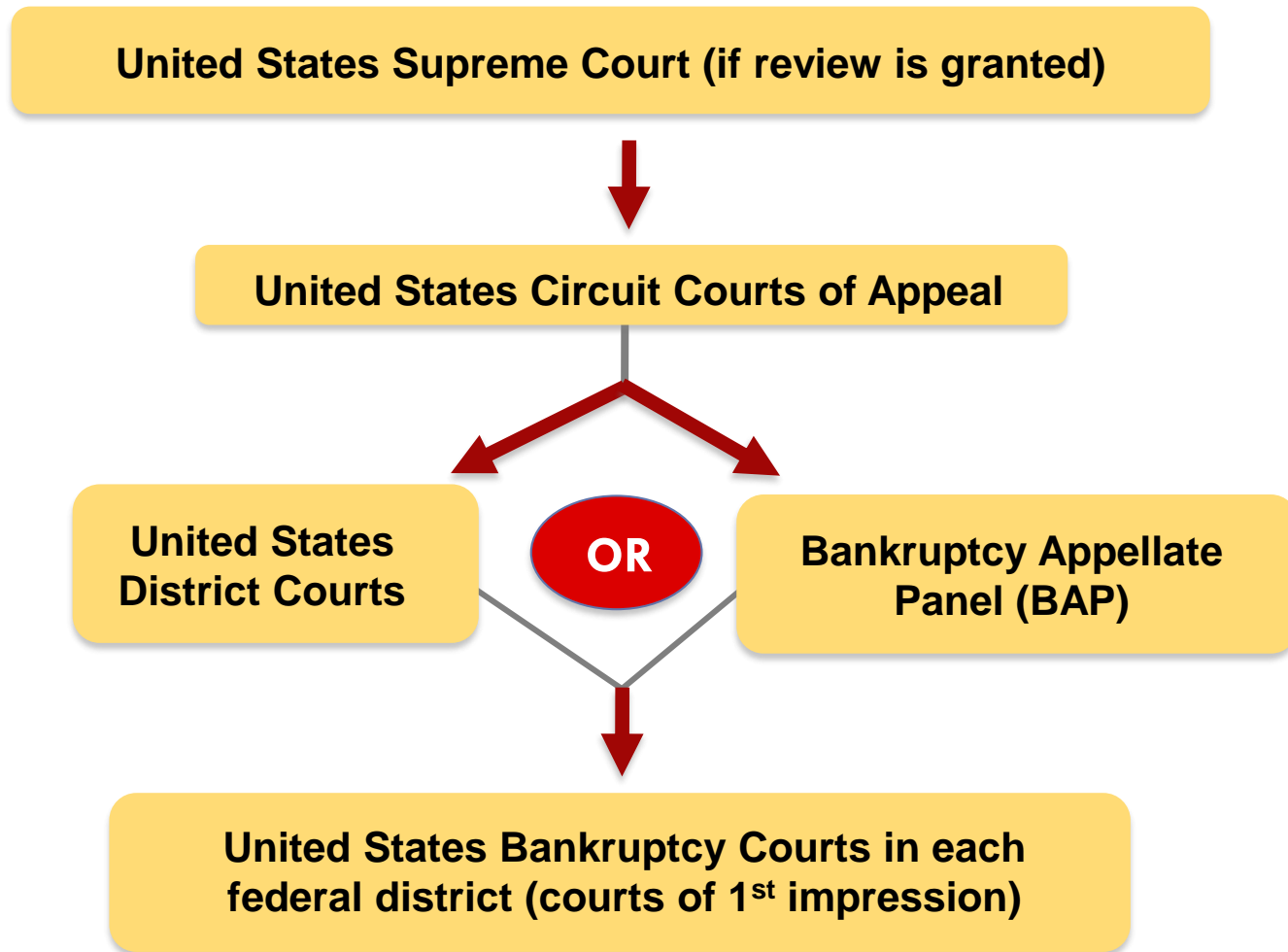
## *What In House Counsel Need to Know about Bankruptcy*

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# The Structure of the Court System with Respect to Bankruptcy



# Voluntary vs. Involuntary Petitions

## Voluntary

- Filed by the debtor

## Involuntary

- Filed by the debtor's unsecured creditors against the debtor
- Requires 3 unsecured creditors to file if the debtor has 12 or more creditors
- Claims of filing creditors must be non-contingent, undisputed, and aggregate to over \$16,750

# The Bankruptcy Estate and Financial Disclosure by the Debtor

- The filing of a bankruptcy petition creates a “bankruptcy estate” consisting of all legal or equitable interests of the debtor in property
- Butner Principle: Rights in property generally determined by non-bankruptcy law unless bankruptcy requires otherwise
- Debtor is subject to broad financial disclosure, including the filing of detailed schedule of assets and liabilities shortly after the petition date



# Chapter 7 vs. Chapter 11 Bankruptcies

## Chapter 7: Liquidation

- A Trustee is appointed to reduce the debtor's assets to cash and distribute the proceeds
- Less complicated and costly than a Chapter 11
- Many businesses in Chapter 7 end up here after an unsuccessful Chapter 11

## Chapter 11: Reorganization

- Debtor reorganizes through a plan of reorganization
- Unsecured creditors are usually paid a portion of their claims pro rata, with the remainder discharged
- Debtor emerges as a new entity with a reduced debt load and restructured finances
- Debtor typically remains in control of its assets and business during the case
- Can also be used to liquidate troubled or complicated assets
- Subchapter V provides expedited process for smaller businesses

# Other Chapters

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- Chapter 9 – Municipalities
- Chapter 12 – Family Farmers and Family Fisherman
- Chapter 13 – Individuals with Limited Assets and Liabilities
- Chapter 15 – Involves Multi-National Distress Situations in Canada, United Kingdom and Brazil.

# Chapter 9 – Features

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- Voluntary Filings Only: Available only to municipalities such as cities, counties, joint powers authorities which are authorized to file under applicable non-banking laws (e.g., Detroit, County of Orange)
  - Municipality must be insolvent, desire to elect a plan of “adjust” its debts and must either:
    - Obtain agreement of creditors in each class it intends to impair,
    - Fail in a good faith attempt to negotiate with those creditors,
    - Be unable to negotiate because it is impractical, or
    - Reasonably believe a creditor may attempt to obtain a preference
  - Additional state law restrictions may apply
  - Bankruptcy Court has limited powers to interfere with debtor’s operations
  - Only the debtor can propose a plan
  - Plan of adjustment confirmation standards differ for Chapter 11 due to, among other things, constitutional concerns

# Chapter 15 – Features

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- Allows for the recognition in the U.S. of foreign bankruptcy proceedings and access to domestic judicial proceedings by foreign representatives.
- Provides structure to address distress situations which involve parties in multiple countries.
- Typically ancillary to a primary proceeding initiated outside U.S.
- Permits coordination with the foreign proceeding via limiting assets subject to U.S. jurisdictions.



# The Players in Bankruptcy

## TRUSTEE

- Representative of the bankruptcy estate that takes control of debtor's assets and administers case
- Usually in Chapter 7

## DEBTOR-IN-POSSESSION

- Debtor that remains in control of its assets and business affairs during the case
- Possesses the same powers as a trustee

## U.S. TRUSTEE

- Government official that oversees bankruptcy cases and appoints Trustees and Committees
- More prominent in Chapter 11 cases

## CREDITORS' COMMITTEE

- Typically 5 to 7 creditors representing the interests of ALL unsecured creditors
- Organized and appointed by the U.S. Trustee
- Investigates the debtor's finances and negotiates with the debtor over the provisions of the plan of reorganization

# The Automatic Stay

- Imposed automatically by the filing of a bankruptcy petition
- Stays (*i.e.*, suspends) all actions and efforts to collect on account of claims against debtor that arose pre-petition
- Does not apply to officers and directors of debtor, to related entities, or to claims against the debtor that arose post-petition
- Creditors may seek relief from stay to collect on pre-petition debt, but must generally show “cause”
- Debtor may seek a Bankruptcy Code Section 105 injunction against related non-Debtor third parties



# Executory Contracts

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- These are contracts on which material performance remains due on both sides – e.g., leases, construction or supply contracts, licenses
- Debtor-in-possession may assume or reject executory contracts
  - Assumption requires cure of all defaults
  - If assumed, debtor-in-possession can assign the contract to another party
  - Rejection leads to unsecured claim for breach
  - Administrative priority claims may arise regarding post-petition/pre-rejection obligations
- Some contracts cannot be assumed notwithstanding the fact that they are executory, including:
  - Contracts for financial accommodations
  - Contracts where non-bankruptcy law excuses a party from accepting performance from someone other than the debtor, and the counterparty does not consent to assumption or assignment
    - Usually these apply to contracts for personal services
    - Debtor-licensee's rights to assign certain IP licensee are not absolute

# Fraudulent Conveyances and Preferences

## Fraudulent Conveyances

- Exist in the Bankruptcy Code and under state law.
- Apply when debtor transfers property interests or incurs debt.
- Complicated test, can be actual or constructive fraud, knowing or unknowing.
- For constructive fraud, the key is lack of “reasonably equivalent value”.
- 2-year reachback period in bankruptcy, longer in some state versions (*i.e.*, 4 years in CA).
- May overlap with alter ego and single enterprise exposure for nondebtors.

## Preferences

- Generally transfers made within 90 days of the bankruptcy petition on account of antecedent debt; one year for insiders.
- Apply only to transfers of property interests (including granting of security interests).
- Statutory affirmative defenses include: contemporaneous exchange, ordinary course, new value.
- Classic examples are collection on “old” accounts receivable; litigation settlement payments.

# Plan of Reorganization

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- Classifies creditors and specifies treatment of each class (*i.e.*, who gets what)
- The Plan proponent files a disclosure statement to inform voting creditors re the plan
- Confirmation of the plan may be consensual if all impaired classes approve
- Confirmation may be nonconsensual (“cram down”), but the plan must meet additional requirements including the “fair and equitable” test

# Chapter 11 Procedure and Timing

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1. Case begins with filing of bankruptcy petition
2. Early case events include debtor's "early case motions (first day filings)," proposed Debtor-in-Possession ("DIP") financings, filing of debtor's schedules, meeting of creditors, and setting of proof of claim bar date
3. Most creditors need to file proof of claim by bar date to recover on account of pre-petition claim
4. Claim deemed allowed unless objected to
5. Plan confirmation process usually begins after claims bar date has passed

# Chapter 11 Procedure (cont'd)

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6. Debtor-in-possession or other interested party files plan of reorganization and disclosure statement
7. Court holds hearing on disclosure statement
8. Voting on the plan occurs – classification process is critical
9. Court holds plan confirmation hearing
  - If all parties are not in support, then court applies “Cram Down” test
10. If confirmed, court enters the confirmation order – Does it attempt to include third party releases?
11. Plan is implemented, effective date occurs, and debtor emerges from bankruptcy protection
12. Final decree when case “fully administered”

# “363” Sales of Debtor Assets

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- Chapter 11 Debtors may seek Bankruptcy Court approval to sell assets “free and clear of liens” with liens attached to the proceeds
- Process may begin pre-petition as part of a “pre-packaged” strategy or post-petition
- Proposed process involves
  - Typically a “stalking horse bidder” to set the minimum bid and will entail a “break-up fee” to be paid if the bidder is not the winning bidder
  - Court approves a protocol which will likely entail:
    - A period (often 45-60 days) for interested parties to conduct due diligence
    - A deadline for parties who are qualified bidders to submit bid offers
    - The Debtor holding an auction and then seeking court approval of the “winning bidder” and a “back-up bidder”
    - The Court entering a detailed order approving the sale
    - Sale closes subsequently



# Questions?



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# Thank You!

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