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Chapter 11 of the Bankruptcy Code: A Primer for Montana Attorneys

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ARTICLES

CHAPTER 11 OF THE BANKRUPTCY CODE: A PRIMER FOR MONTANA ATTORNEYS

Donald MacDonald IV* and Joan Newman**

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I. INTRODUCTION

A. Montana's Business Economy

It is no secret that Montana, particularly western Montana, is in the midst of a profound economic slump. While eastern Montana has booming oil, gas and coal industries, western Montana's primary source of employment, its wood products industry, has been devastated by continuously high interest rates and a disastrous housing market.¹ The outlook for the industry became grim in 1979 and has not improved substantially since then. A recent article in the *Montana Business Quarterly* indicated that "1981 will be another tough year for the wood products industry."² A spokesman for Champion International Corporation in Missoula recently stated that general market conditions are the worst since the great depression of the 1930s.³

A slowdown in the wood products industry, the closure of the Anaconda smelter, and high interest rates have spelled disaster for many businesses in Montana.⁴ This economic decline is further documented by the statistics on straight bankruptcy filings. In Montana alone, bankruptcy filings were up 63.1 percent from 1979 to 1980.⁵ Although the statistics are not yet available, indications are that 1981 will see a similar increase.

This economic turmoil has inevitably led many businessmen to seriously question how they can survive these hard times. Many businessmen are familiar with Chapter 11 business reorganization in bankruptcy.⁶ Some regard it as a panacea for all their ills; others

1. Johnson, *Economic Update: Montana's Outlook at Midyear*, MONT. BUS. Q., Summer 1980, at 6.

2. Johnson, *Montana in 1981: An Economic Perspective*, MONT. BUS. Q., Spring 1981, at 10.

3. *Mills Go to 4-day Week*, Missoulian, October 13, 1981, B-12, col. 1.

4. Of the Montana Chapter 11 cases surveyed for this article (see note 9 *infra*), about half the businesses were started during the last four years. Of the older businesses, many were wood products industries or recreation related businesses. The types of Montana businesses in some stage of Chapter 11 were:

<i>Businesses</i>	<i>Percent of total cases</i>
Vacation/recreation industry	23%
Automobile sales/service	20%
Wood product industry	17%
Real estate/development	13%
Heavy construction	10%
Other	17%

5. DIVISION OF STATISTICAL ANALYSIS AND REPORTS, ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, FEDERAL JUDICIAL WORKLOADS DURING THE TWELVE-MONTH PERIOD ENDING SEPTEMBER 30, 1980, 16 (1980).

6. The specific provisions for business reorganization in bankruptcy are contained in Chapter 11 of Title 11 of the United States Code. To distinguish these proceedings from

recognize it as a complex, structured method of reorganizing business.

B. *The Need for a Chapter 11 Primer*

What is Chapter 11 and how can it help these business clients? Many Montana lawyers simply do not know. Because the Bankruptcy Reform Act of 1978⁷ is new, and because there were few business reorganizations under Montana's once healthy economy, Montana lawyers do not know much about reorganizations. In many instances lawyers from larger cities who specialize in such matters have been employed by Montana businesses. Is Chapter 11 a panacea for all the ills of a business? What can it accomplish? What has it accomplished thus far in Montana? These are some of the questions to be addressed in this article. Chapter 11 proceedings are not inherently simple. The primary purpose of this article is to give Montana attorneys a direct and concise explanation of Chapter 11 of the current Bankruptcy Code.⁸ The article is directed to Montana attorneys with little or no prior knowledge of the Bankruptcy Code. The secondary purpose of this article is to inform Montana attorneys of what has occurred thus far in Montana Chapter 11 cases and to give them direction for planning future proceedings.⁹ Through the information contained in this article, Montana attorneys will be able to evaluate intelligently the advantages and disadvantages of a Chapter 11 proceeding from a creditor's or debtor's point of view.

"straight" bankruptcy under Chapter 7 of Title 11, and other bankruptcy proceedings, business reorganization in bankruptcy is commonly called "Chapter 11."

7. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978), became effective October 1, 1979. All section references in text and citation in footnotes are to Title 11 of the United States Code (Supp. III 1979), unless otherwise indicated.

8. Bankruptcy statutes prior to the current provisions were commonly referred to as the "Act." The current statutes are commonly called the "Bankruptcy Code" or the "Code."

9. In preparation for this article, all the Chapter 11 cases filed in Montana under the Code since October 1, 1979, were surveyed by examining the court files. The authors express their appreciation to the Honorable John L. Peterson and the Honorable Orville Gray, United States Bankruptcy Judges for Montana; to Michael Bell, Clerk of the Bankruptcy Court, and to Julia Wilson and Lucy Pesanti, Deputy Clerks, without whose assistance this article would have been infinitely more difficult.

There were 27 active cases in Montana at the time of the survey. Of these, 11 were in very early states of administration. The conclusions and suggestions offered in this article are based on this small sample of active cases, and on the authors' collective experience and study.

Many elements of both planning and proceeding in a Chapter 11 are legal problems. Some of the most troublesome problems, however, are human relations problems or business judgment and finance problems. The focus of this article, therefore, is on these practical aspects of facilitating a successful Chapter 11 reorganization, as well as on the legal aspects.

C. Preliminary Points

1. Applicable Bankruptcy Code Provisions

Not all of the law concerning Chapter 11 is contained in Chapter 11 of the Bankruptcy Code. With some minor exceptions, Chapters 1, 3 and 5 apply to Chapter 11.¹⁰ These chapters also apply to Chapter 7 liquidations and Chapter 13 plans for individuals with regular income.¹¹ These are general provisions of the Code, including the definitional sections,¹² provisions dealing with case administration,¹³ creditors' claims,¹⁴ debtor's duties and benefits,¹⁵ and the estate.¹⁶

It is also significant to note that the debtor-in-possession (hereafter referred to as debtor) has all of the powers of a trustee except the right to compensation.¹⁷ Thus, whenever the Code refers to the trustee's strong arm power,¹⁸ the trustee's right to sell or lease property,¹⁹ the trustee's power to avoid preferences,²⁰ and so on, it must be kept in mind that the debtor under Chapter 11 also has that power.

2. Status of the Bankruptcy Rules

The status of the bankruptcy rules²¹ presents a somewhat confusing picture. The older rules approved by the Supreme Court for use with the old Act still apply to the extent that they are not inconsistent with the Code.²² New rules are being drafted that are to be completed and approved by the Supreme Court.²³ A set of interim rules has been drafted by the advisory committee on bankruptcy rules of the Judicial Conference of the United States.²⁴ These interim rules have been adopted in Montana along with the

10. 11 U.S.C. § 103(a).

11. *Id.*

12. 11 U.S.C. §§ 101-9.

13. 11 U.S.C. §§ 301-66.

14. 11 U.S.C. §§ 501-10.

15. 11 U.S.C. §§ 521-25.

16. 11 U.S.C. §§ 541-54.

17. 11 U.S.C. § 1107(a).

18. 11 U.S.C. § 544(a).

19. 11 U.S.C. §§ 363(b), (c).

20. 11 U.S.C. § 547(b).

21. The Rules of Bankruptcy Procedure, 11 U.S.C. app. (1976), were adopted by the Supreme Court pursuant to 28 U.S.C. § 2075 (1976).

22. Pub. L. No. 95-598, § 405(d), 92 Stat. 2549 (1978).

23. ADVISORY COMMITTEE ON BANKRUPTCY RULES, JUDICIAL CONFERENCE OF THE UNITED STATES, SUGGESTED INTERIM BANKRUPTCY RULES, 1 (West 1981) [hereinafter cited as INTERIM RULES].

24. *Id.*

local rules.²⁵

3. *Notice and Hearing Requirements*

Another significant change found in the Code needs to be stressed. The Code is replete with references to "notice and hearing" requirements. For example, under section 363, after notice and a hearing, the trustee may use, sell or lease property of the estate.²⁶ The Code states:

"[A]fter notice and a hearing," or a similar phrase—

(A) means after such notice as is appropriate in particular circumstances, and such opportunity for a hearing as is appropriate in particular circumstances; but

(B) authorizes an act without an actual hearing and such notice is given properly and if—

(i) such a hearing is not requested timely by a party in interest; or

(ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act.²⁷

"After notice and a hearing" will be further defined by the bankruptcy rules. However, it is important to know that the hearing is not mandatory in every instance.²⁸ If there is no objection to the proposed action, the action may proceed without court confirmation. The purpose of this provision is to remove the bankruptcy judge from the administration of the case.²⁹ He is to become involved only when there is a dispute.

II. THE PURPOSE OF REORGANIZATION

Why is there a business reorganization chapter in the Bankruptcy Code? The rationale for Chapter 11 is contained in its legislative history:

The purpose of a reorganization case, unlike a liquidation case, is to restructure a business' finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for shareholders. The premise of a business reorganization is that assets that are used for production in the

25. UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF MONTANA, LOCAL RULES, Rule 1 (adopted March 3, 1980).

26. 11 U.S.C. § 363(b).

27. 11 U.S.C. § 102(1).

28. H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 315 (1977) (reprinted in 3 COLLIER PAMPHLET EDITION BANKRUPTCY CODE 32 (1979)) [hereinafter cited as COLLIER PAMPHLET].

29. *Id.*

industry for which they were designed are more valuable than those same assets sold for scrap. Often, the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop and require creditors of the business, both trade creditors and long-term lenders, to wait for payment of their claims. If the business can extend and reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.³⁰

A. *Composition and Extension*

The rationale above is similar to that for extension or composition agreements. A composition is an agreement between two or more creditors to take a specified partial payment in full satisfaction of their claim. An extension agreement is a contract between two or more creditors to extend the debtor's time of payment. An agreement can have both composition and extension features and will thus be an agreement for creditors to take less over a longer period of time. Almost every attorney engaged in Montana business practice has had the opportunity to make such arrangements. In its simplest terms, Chapter 11 is a vehicle for modifying debtor-creditor relationships in the same way as a composition and extension agreement.³¹

These traditional out-of-court agreements, however, require near unanimity among creditors and may not accomplish the needs of larger or more complex businesses. Reorganization in bankruptcy provides an alternative:

When an out-of-court arrangement is inadequate to rehabilitate a business, the bankruptcy laws provide an alternative. An arrangement or reorganization accomplished under the Bankruptcy Act binds nonconsenting creditors, and permits more substantial restructuring of a debtor's finances than does an out-of-court workout.³²

Chapter 11 thus provides a more comprehensive framework for a complete reorganization than can be obtained out of court in a typical composition and extension agreement.

30. H.R. REP. No. 95-595, 95th Cong., 1st Sess. 220 (1977). The full text of the House Report can be found at 1978 U.S. CODE CONG. & AD. NEWS 5963-6435.

31. *Id.*

32. *Id.*

B. Return for Shareholders

One purpose of Chapter 11, that of obtaining a return for shareholders,³³ does not have significant application in Montana where there are few large publicly held corporations.³⁴ However, that purpose helps to explain many of the Code's provisions. Chapter 11 is the only business reorganization chapter available for corporations, partnerships and individuals having secured debts over \$350,000 and unsecured debts over \$100,000.³⁵ Chapter 11 can apply to a small family-owned store as well as to Chrysler Corporation.³⁶ Because of the broad scope of this chapter, there often may be requirements that seem burdensome in an individual case.

It should also be noted that many of the Code's requirements center around securities regulations and considerations inherent in publicly held corporations.³⁷ By going public, these corporations have created, at one time or another, substantial equity. Most Montana corporations have never had this type of capital injection. For the most part they have been highly leveraged without a substantial owner's equity or capital contribution. The possibility of successful reorganizations under these circumstances is made much more difficult because many Montana businesses do not have the equity cushion needed for survival. Even though a publicly held corporation may have incurred substantial losses, the initial injection of capital puts them in a much stronger reorganization position than the typical Montana corporation.

C. Orderly Liquidation

One purpose of Chapter 11 that is usually not considered as a primary goal of the reorganization chapter is that of orderly liquidation of a business. As an alternative to immediate liquidation by a trustee under Chapter 7, Chapter 11 specifically authorizes liquidating plans.³⁸ Continuous operation of the business is not always required.³⁹

33. See text accompanying note 30 *supra*.

34. Of the Montana Chapter 11 businesses, 17 are corporations, two are partnerships, and 15 are individuals or individuals filing joint petitions. All of the corporations are closeheld corporations, typically among families or a few major stockholders. There are eight joint petitions of husband and wife business ventures.

35. 11 U.S.C. § 109(e). See generally H.R. REP. No. 95-595, 95th Cong., 1st Sess. 318-20 (1977) (reprinted in 3 COLLIER PAMPHLET, *supra* note 28, at 48-49).

36. H.R. REP. No. 95-595, 95th Cong., 1st Sess. 221 (1977).

37. *E.g.*, 11 U.S.C. §§ 1109(a), 1125(d), (e).

38. 11 U.S.C. § 1123(b)(4).

39. 11 U.S.C. §§ 1107, 1108.

D. Specific Advantages of Reorganization Under Chapter 11

The general advantages and purposes of Chapter 11 have been discussed above. The following paragraphs describe some specific advantages of Chapter 11 over nonbankruptcy remedies.

1. The Automatic Stay

One of the primary advantages of Chapter 11 over nonbankruptcy remedies is the automatic stay.⁴⁰ The stay prevents any collection action or lien enforcement from being pursued after the filing of the petition,⁴¹ and it frees cash flow during the pre-plan period from payment of prior debts. The automatic stay gives the debtor a respite from collection actions during which to design the reorganization plan.

2. Recovery of Preferences

Another significant advantage to the debtor is the recovery of preferences.⁴² The debtor can recover payments or avoid security interests given within 90 days of the petition if these transfers were preferential.⁴³ Recovery of preferences may be necessary to reorganization if a substantial payment has been made to a previously unsecured creditor.⁴⁴

3. Cessation of Interest

Another advantage to the debtor is the cessation of all interest on unsecured debt.⁴⁵ Section 502 limits interest on unsecured claims to the amount as of the date of the petition. This provision allows the debtor the breathing space necessary to get the cash flow in a position to reorganize.

4. Jurisdiction of the Bankruptcy Court

An additional advantage of Chapter 11 is the broad jurisdiction of the bankruptcy court.⁴⁶ Briefly stated, the bankruptcy court has jurisdiction over any matter that arises out of the bankruptcy.

40. 11 U.S.C. § 362.

41. 11 U.S.C. §§ 362(a)(1), (2).

42. 11 U.S.C. § 547.

43. 11 U.S.C. § 547(b).

44. There have been few actions to recover preferences in the Montana cases. One reason may be that recovery of preferences has been overlooked as a power of the debtor-in-possession. See text accompanying notes 10-17 *supra*.

45. 11 U.S.C. § 502(b)(2).

46. 11 U.S.C. § 105(a); 28 U.S.C. § 1471 (Supp. III 1979).

This means that the debtor may not have to defend suits in multiple courts. Rather, it will be within a single forum, with a better opportunity to defend its position in light of the protections of the Code.

5. *The Strong Arm Statute*

The strong arm provision of section 544 may also induce a debtor to file. Simply stated, the strong arm provision increases the debtor's power against certain security interests by giving it the rights of a lien creditor.⁴⁷

6. *Advantages to Creditors*

The chief advantage of the creditors filing an involuntary petition in bankruptcy is the possibility of a change in management. The creditors have the ability to replace the debtor-in-possession with a trustee or examiner upon a showing of good cause.⁴⁸ This could include such elements as gross mismanagement or use of corporate assets for an insider's personal benefit.⁴⁹ Also a nonpreferred creditor can promote the recovery of preferences to be distributed uniformly to all unsecured creditors.⁵⁰ Another advantage to the creditor is that no sales out of the ordinary course of business can be made by the debtor without notice and hearing.⁵¹ The creditors have the opportunity to object and present their views to the court when sales out of the ordinary course of business are contemplated by the debtor.

An advantage to both debtor and creditors is the provision of section 363 allowing sales free and clear of liens and encumbrances.⁵² This provision can be a great advantage to a debtor who is unable to obtain clear title to property on which there is some dispute as to the validity of the security interest. In the sale free and clear of liens and encumbrances, all valid liens and encumbrances attach to the proceeds. The purchaser is assured of a clear title and the other parties are left free to pursue their claims against the proceeds.

47. 11 U.S.C. §§ 544(a), (b).

48. 11 U.S.C. §§ 1104(a), (b).

49. 11 U.S.C. § 1104(a)(1).

50. See text accompanying notes 42-44 *supra*.

51. 11 U.S.C. §§ 1107(a), 363(b).

52. 11 U.S.C. § 363(f).

E. Pre-petition Planning**1. The Initial Decision to Proceed Under Chapter 11**

Some of the specific advantages to reorganization in bankruptcy have been discussed above. The initial decision to file under Chapter 11, however, should focus on the potential success of the specific business continuing in a reorganized form. That decision should be made after considering (1) the basic viability of the business in the community, (2) the strength of management, (3) attitudes of creditors toward reorganization, and (4) the asset-to-liability ratio and potential for financial restructuring.⁵³ Chapter 11 reorganizations have been most successful where the ongoing business is important to the community, the attitudes of creditors are favorable, and the debts are not overwhelming. An orderly liquidation is not advisable unless the attorney can show advantages over a straight liquidation.

It is imperative that the debtor's attorney realistically evaluate the debtor's business and the debtor's managerial abilities. These are the most important factors to be evaluated in any Chapter 11 proceeding. The debtor's attorney should ask himself: Was the business successful before the current economic downturn? Has the business ever been successful? Has the business manager ever been associated with a successful, profitable business? One of the most common reasons for the failure of many Montana Chapter 11 cases is that the debtor's attorney has failed to ask these questions and objectively evaluate his client and his client's business. The attorney must familiarize himself with the business by discussing its basic viability with people other than his client. Possible outside contacts include the debtor's accountant and competitors, as well as economists, business and managerial consultants and any other third parties who could offer an evaluation of the debtor and the business. The failure to make this initial analysis can be disastrous both for the debtor and the debtor's attorney. The debtor may waste possibly exempt assets to keep the business going. The debtor's attorney may face the possibility of never being reimbursed for his time and effort because the business simply does not have the ability to pay even administrative expenses. The attorney must evaluate these nonlegal business considerations prior to the initiation of any proceedings.

An additional consideration in the case of individuals, sole proprietorships, and joint petitions of individuals is whether they

53. The conclusions and suggestions in this section are based on the experience of the authors and on observations from Chapter 11 cases in Montana. See note 9 *supra*.

might be better advised to proceed under Chapter 13.⁵⁴ The advantages of Chapter 13 over Chapter 11 are mainly the simplified requirements of the plan,⁵⁵ less complex and expensive administration of the case and more comprehensive discharge.⁵⁶ A complete discussion of Chapter 13 cases is contained in a companion article in this issue.⁵⁷

2. *Reducing Post-petition Creditor Actions*

An attorney who represents a business on other matters is well-advised to keep in tune with the signals of impending insolvency. Where possible, pre-petition planning with the debtor and negotiations with creditors will substantially reduce post-petition creditor actions.⁵⁸ The Code allows pre-petition creditors' committees to continue to serve if fairly selected and representative.⁵⁹ Pre-petition acceptances of the plan may be counted if based on adequate disclosure.⁶⁰ Also the debtor's pre-petition professional consultants may continue to serve.⁶¹

Although the filing of the petition invokes the automatic stay against many creditor actions,⁶² it also invokes the insecurity of creditors who will begin actions to protect their interests. The main post-petition concern of the debtor's attorney should be designing the reorganization plan and disclosure statement. Pre-petition planning, where possible, will provide the information necessary to allay creditors' fears and eliminate many post-petition creditor actions.

III. PROCEEDING UNDER CHAPTER 11

A. *Commencement of the Case*

Assuming that it has been determined that a Chapter 11 proceeding is warranted, how is it initiated and who is eligible to file?

54. 11 U.S.C. §§ 1301-30. Smaller businesses that meet the debt requirements may proceed under Chapter 13; corporations and partnerships may not. 11 U.S.C. § 109(d).

55. 11 U.S.C. § 1322(a).

56. 11 U.S.C. § 1328.

57. Harold V. Dye's article, entitled *An Overview of Chapter 13—Its Uses and Abuses*, follows this article.

58. Two of the most successful Montana cases have involved pre-petition cooperation and negotiation with creditors.

59. 11 U.S.C. § 1102(b)(1).

60. 11 U.S.C. § 1126(b).

61. 11 U.S.C. §§ 1107(a), (b), 327(c).

62. See text accompanying notes 40-41 *supra*.

1. *The Petition and Schedules*

A voluntary petition under Chapter 11 is very simple to initiate. All that is required is that the petitioner or its attorney file a petition stating the petitioner's name and address, that it has had its principal place of business within the district for the preceding 180 days and that it is qualified to file the petition under Title 11 of the United States Code.⁶³ The petitioner must state that a copy of the plan will be filed pursuant to Chapter 11. Along with the initial petition, the debtor must file a list of the names and addresses of its 10 largest unsecured creditors, excluding insiders.⁶⁴ The debtor is required to file all of the schedules, statements and lists generally associated with a liquidation case within 15 days after the filing of the petition.⁶⁵ The court may grant an extension of time for the filing of the schedules for cause shown and after notice to such parties as the court may direct.⁶⁶ If there are shareholders, referred to in the Code as "equity security holders," a list of the shareholders of each class, showing the number and kind of interests registered and the addresses and places of business of the shareholders must be filed. Also, all of the schedules of assets and liabilities normal for a liquidation case, such as schedule A-1 priority creditors, schedule A-2 secured creditors, and schedule A-3 unsecured creditors, are required. The schedule B statements showing all property of the debtor must be included, as well as a statement of executory contracts and a statement of financial affairs. All of the A and B schedules must be provided by the debtor within 15 days after the entry of the order for relief or later upon good cause shown.

2. *Involuntary Petitions*

An involuntary petition under Chapter 11 may be filed against a debtor by its creditors.⁶⁷ If there are more than 12 creditors, at least three entities with claims of \$5,000 or more in the aggregate may bring an involuntary petition against the debtor. If there are fewer than 12 creditors, one or more of such creditors that holds at least \$5,000 of the claim may bring the petition.⁶⁸ The test for granting the relief in an involuntary case is whether the debtor is generally paying its debts as they become due, or whether a custo-

63. INTERIM RULES, Rule 1002; Interim Form No. 1.

64. INTERIM RULES, Rule 1007(a).

65. INTERIM RULES, Rule 1007(d).

66. *Id.*

67. 11 U.S.C. § 303(a).

68. 11 U.S.C. § 303(b).

dian was appointed or took possession of the debtor's property within the preceding 120 days.⁶⁹ The problem faced by the petitioning creditor is that if the court should dismiss a petition, judgment may be granted against the petitioners for costs, attorney's fees and damages for taking possession of the debtor's property improperly.⁷⁰ If the petition was filed in bad faith, the debtor is entitled to punitive damages.⁷¹ As a practical note, however, all Montana cases under the new Code have been voluntary petitions.

3. *Eligible Business Entities*

Generally, any individual, partnership or corporation can file a petition for voluntary relief under Chapter 11 except for insurance companies, banks, savings and loans, stockbrokers and commodity brokers.⁷² No involuntary petition can be brought against a farmer or corporation that is not a "moneyed, business or commercial corporation,"⁷³ such as churches, schools, and charitable organizations and foundations. These entities receive the advantage of being able to file voluntarily, but no involuntary relief can be brought against them.

B. *Administration: Who is in Charge?*

1. *The Debtor-in-Possession*

Upon the filing of a Chapter 11 petition, the creditors have no automatic right to the appointment of a trustee. The debtor will remain in charge of all of its assets and continue running the business unless a party in interest can show cause for the appointment of a trustee or examiner.⁷⁴ Grounds for the appointment of a trustee include fraud, dishonesty, incompetence or gross mismanagement. Short of having a trustee appointed, the court can order the appointment of an examiner.⁷⁵ This is a new position created by the Code. The examiner is by no means in charge of the proceedings, but he can be ordered, after notice and a hearing to "conduct such an investigation of the debtor as is appropriate, including investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity in the management of

69. 11 U.S.C. § 303(h).

70. 11 U.S.C. § 303(i).

71. *Id.*

72. 11 U.S.C. §§ 109(b), (d).

73. 11 U.S.C. § 303(a).

74. 11 U.S.C. §§ 1107, 1108.

75. 11 U.S.C. § 1104(b).

the affairs of the debtor"⁷⁶

The person who is not in charge of the administration of the case is the judge. His purpose under the new Code is not to act as an administrator but rather to resolve disputes and adversary matters.⁷⁷ No longer does the judge preside over the initial meeting of creditors. Unless there is an immediate motion for appointment of a trustee or examiner, or a hearing on cash collateral, the judge will have little initial contact with the case except in the initial appointment of a creditors' committee.

2. *Creditors' Committees*

The creditors' committee should play an important role in the Chapter 11 process.⁷⁸ Its purpose is to take over some of the administrative functions formerly performed by the judge. As pointed out in a recent article:

It is intended that the committee . . . oversee the debtor in the reorganizational process, as distinguished from the court involving itself in the everyday affairs of the debtor. The court's role should be limited to a judicial one, that is, dispute resolving, and it should play no administrative part in the continued operations of the debtor. Thus, the committee should, early in the case, meet with the debtor, discuss and determine whether the business should be continued, whether a trustee should be applied for, whether there is need for an examiner, or the current executive salaries are appropriate or whether to raise a dispute before the court with respect thereto, and the like.⁷⁹

A big advantage of participation in a creditors' committee is that the creditors may employ independent professionals to represent the committee.⁸⁰ This employment is subject to court confirmation, and a person is prohibited from representing both an individual creditor and a committee at the same time.⁸¹ However, rather than having several lawyers and accountants representing various unsecured creditors, employment of one professional to represent the whole committee can be more efficient. Also, the interests of most unsecured creditors are often parallel and there is no

76. *Id.*

77. H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 315, 331 (1977).

78. 11 U.S.C. § 1103(c). See generally DeNatale, *The Creditors Committee Under the Bankruptcy Code*, 45 AM. BANKR. L.J. 43 (1981).

79. King, *Chapter 11 of the 1978 Bankruptcy Code*, 53 AM. BANKR. L.J. 107, 112 (1979).

80. 11 U.S.C. § 1103(a).

81. 11 U.S.C. § 1103(b).

real need for many different attorneys and accountants to represent creditors with similar interests.

The committee has broad power to oversee the debtor, negotiate with the debtor concerning the plan, recommend a plan and even file its own plan after the debtor's plan exclusivity has lapsed.⁸² If effectively utilized, the creditors' committee can have a substantial impact on the overall proceedings.

C. *Post-petition Activities*

1. *Secured Creditors' Rights*

Two significant events that involve secured creditors may occur after a case is commenced but prior to the first meeting of creditors. Subject to some exceptions, secured creditors with "floating" security interests in after-acquired inventory, receivables or the like lose their right to post-petition proceeds.⁸³ Also, the debtor may not use, sell or lease "cash collateral" unless the court authorizes its use. In order to utilize the cash, there must be a showing of "adequate protection" for the secured creditor.⁸⁴ If the debtor cannot show how the creditors are protected, it can be deprived of the use of the cash. With no cash, the business will obviously be incapable of functioning. Thus, the significance of this provision cannot be underestimated. If the business loses its cash collateral, it loses any chance to an effective reorganization.

2. *Examination of the Debtor*

After filing, or after adjudication as an involuntary bankrupt, the debtor-in-possession must appear and be examined under oath by the creditors.⁸⁵ The Code does not prescribe any specific purpose to be served by the meeting, but the meeting necessarily serves as a forum for negotiation regarding the plan of reorganization. All parties have an opportunity to meet and discuss possible resolution of the debtor's financial problems. Also, the meeting is a discovery device for creditors seeking recovery of preferences or the appointment of a trustee or examiner. Secured creditors may also wish to direct questions to the debtor regarding release of their secured property, its value and its need and use in the reorganized entity.

82. 11 U.S.C. § 1121(c). As a practical matter, however, it appears few plans will be filed by creditors. In no case in Montana has a plan been filed by creditors.

83. 11 U.S.C. § 552(b).

84. 11 U.S.C. § 363(c)(2).

85. 11 U.S.C. §§ 341, 343.

3. *Applications for Relief from the Stay*

Many secured creditors will immediately seek relief from the automatic stay following the filing of the petition.⁸⁶ As noted earlier, the automatic stay is one of the fundamental protections for the debtor provided by the Code. The automatic stay does not necessarily go on forever, however, and a party in interest can obtain relief from the stay if he can show "lack of adequate protection" or other grounds.⁸⁷ An example of lack of adequate protection would be the continuous use or depreciation of a piece of equipment which is fully encumbered. Alternatively, the secured party can allege that the debtor has no equity and that the property is not necessary for an effective reorganization.⁸⁸ If a creditor can prove these allegations at a hearing, the judge may release the collateral. These proceedings may occupy a significant amount of the post-petition hearings.

4. *Executory Contracts*

It should be noted that one misunderstood application of the automatic stay rule is the effect of the stay on land sale contracts. Land sale contracts are executory contracts and are subject to the provisions of the Code dealing with executory contracts.⁸⁹ For example, suppose a developer is a purchaser under a number of contracts for deed in which he has substantial equities. He has had a great deal of trouble, however, selling the lots in the subdivisions or the homes that he has built and developments subject to the contracts. After default, and as the end of his 30-day grace period approaches, he seeks the protection of the automatic stay and files a petition in bankruptcy. The debtor feels that over a two-year period he can market sufficient properties to cure the default and rehabilitate his business. However, he cannot cure the default immediately and assumes the stay protects him. The debtor seeks to sell a small portion of the real estate later, but the title company will not insure it. Why?

Under section 108(b) the default continues to run; the debtor is only given an additional 60 days within which to cure his default.⁹⁰ If he fails to cure within that period as well as to provide "adequate assurance" (usually cash) of future performance, the

86. 11 U.S.C. § 362(d).

87. 11 U.S.C. § 362(d)(1).

88. 11 U.S.C. § 362(d)(2). In the Montana cases, release of collateral has rarely been allowed before the plan is filed unless the debtor consents.

89. 11 U.S.C. § 365.

90. 11 U.S.C. §§ 108(b)(2), 365(b)(1).

debtor has lost his equity in the property. The automatic stay has not been violated because there has been no affirmative act on the part of the creditor to create, perfect or enforce a lien; time has simply elapsed.

5. *Motions to Dismiss or Convert*

Creditors who believe that the reorganization is not promoting their interests may also seek a conversion or dismissal of the proceeding.⁹¹ Conversion of the case to Chapter 7 liquidation is permitted under certain circumstances. With some exceptions, the debtor may seek a conversion to Chapter 7 without cause.⁹² The creditor, however, can obtain conversion only for cause, and the court can either convert or dismiss the petition as it deems in the best interests of the creditors. Some of the more significant grounds for a conversion or dismissal are: (1) continued loss to or diminution of the estate in the absence of reasonable likelihood of rehabilitation; (2) inability to effectuate a plan; (3) unreasonable delay by the debtor that is prejudicial to creditors; and (4) failure to propose a plan within a time fixed by the court.⁹³

6. *Other Post-petition Activities*

After the filing of the plan, all creditors should carefully review the petition to insure that their claims are accurately listed. If the claim is accurately listed, and not listed as disputed, contingent or unliquidated, then no proof of claim need be filed.⁹⁴ However, if it is listed as disputed, contingent or unliquidated, a proof of claim must be filed. A debtor may contest this claim at an appropriate hearing, or negotiate the amount of the claim.⁹⁵

As noted earlier in the article, adversary proceedings can be brought by the debtor to recover preferences. The debtor can also remove litigation that is pending in other courts to the bankruptcy court for adjudication.⁹⁶ Often the bankruptcy court can provide a more convenient forum for the resolution of these disputes and do it in a more timely manner.

These post-filing activities should be kept in perspective, however. Typical post-filing activities include the first meeting of cred-

91. 11 U.S.C. § 1112.

92. 11 U.S.C. § 1112(a).

93. 11 U.S.C. § 1112(b).

94. 11 U.S.C. § 1111(a).

95. 11 U.S.C. §§ 502(a), (b).

96. 28 U.S.C. §§ 1478, 1479 (Supp. III 1979) (as amended by Pub. L. No. 95-595, § 241(a) (1978)).

itors, applications for relief from the stay, hearings on conversions or dismissals, adversary actions, and the filing of claims. However, the negotiation and drafting of a plan of reorganization should be the primary goal and activity of the debtor and his creditors during this period.

D. *Designing the Plan*

1. *Creative Reorganization*

The particular advantage of Chapter 11 bankruptcy is the opportunity for creative and comprehensive reorganization of the business' financial structure and business operations.⁹⁷ One of the ironies of many Chapter 11 cases is the seeming reluctance on the part of the debtors and creditors alike to change past methods of operation. Yet obviously the business is failing because of these past methods of operation. Designing a plan that is tailored to the reorganization needs of the particular business should be the main objective of the debtor's attorney.

Section 1123 lists many permissible provisions of a plan of reorganization.⁹⁸ The basic premise of nearly all provisions is that creditors' rights can be modified according to the needs of the reorganization. This premise should be the focal point and incentive for negotiation. The debtor's attorney is ill-advised to attempt to squeeze out certain creditors. Similarly, creditors should face the fact that their claims will be compromised. While creditors' acceptance of the reorganization plan is most desirable, neither debtor nor creditors should overlook the potential for confirmation over creditors' objections.⁹⁹ A list of plan proposals from Montana cases is contained in Appendix I.

2. *Use of a Reorganization Team*

The debtor and its attorney are well advised to employ an accountant and a business consultant. If a debtor cannot manage the business, then a manager should be hired also. The successfully reorganized business must be worth the cost of adequate advice, planning and management. Three of the most common troubles in Chapter 11 cases in Montana have been inaccurate evaluation of the viability of the business, incompetent management and inadequate financial records. These problems have contributed to the

97. See text accompanying notes 31-32 *supra*.

98. 11 U.S.C. § 1123(b).

99. 11 U.S.C. § 1129(b). See text accompanying notes 132-40 *infra*.

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relative failure of reorganizations and orderly liquidations alike.¹⁰⁰

The status of the debtor as essentially a trustee permits the employment of professionals subject to court approval.¹⁰¹ Where the temporary employment of such persons is justified in the interest of the estate and creditors, the courts have allowed it. The debtor's attorney who is not equipped to serve all the functions necessary to reorganization should get appropriate assistance early. Where the debtor's attorney knows he will be involved in extensive litigation necessary to the case, he is well advised to get assistance with business judgment, management and financial reorganization. As an alternative to employment of professional advisors, the creditors may provide the needed advice.

3. *Communications with Creditors*

A most important and overlooked resource for all parties in Chapter 11 is the creditors' committee. Section 1102 provides for mandatory appointment of a committee of unsecured creditors.¹⁰² That section also permits a pre-petition committee to continue to serve if fairly chosen and representative. Solicitation by debtor's attorney of the participation and cooperation of creditors seems essential. Their functions could relieve the debtor's attorney of some work, and serve as a forum for negotiation.¹⁰³

Often the secured creditors present the biggest problem in reorganization either because of the necessity of restructuring secured debt or because of actions to release collateral necessary to the business. The debtor and his attorney should soon attempt to obtain the cooperation of these creditors. Hostility between debtor and secured creditors defeats negotiation and cooperation.¹⁰⁴ Formation of a secured creditors' committee is authorized by the Code¹⁰⁵ and can be invaluable. Where the secured creditors are few

100. The overall picture of Montana Chapter 11 plans may be characterized as follows:

Conversions to Chapter 7	2
Dismissals	2
Potentially successful continuation plans	4
Orderly liquidations	4
Disorderly liquidations	8
No plans yet filed	11

Only a few plans of any type have been confirmed.

101. 11 U.S.C. §§ 1107, 327(a).

102. 11 U.S.C. § 1102(a)(1).

103. See 11 U.S.C. § 1103(c) (powers and duties of creditors' committees).

104. The authors are neither naive nor unmindful of the realities of debtor-creditor relations or of the business world. We simply mean to say that Chapter 11 has the most potential for success where debtor and creditors cooperate and negotiate.

105. 11 U.S.C. § 1102(a)(2).

in number or distant, communication and cooperation is nevertheless essential.

E. *The Plan*

Before considering the specific elements of the plan described below, several general concepts regarding plans should be recognized: (1) classification of claims, section 1122; (2) treatment of claims, section 1124; (3) means of executing the plan, section 1123(a)(5); (4) required contents of provisions of a plan, section 1123(a); (5) permissible proposals subject to required contents, section 1123(b); (6) mandatory conditions for confirmation, section 1129(a); and (7) the exception to mandatory conditions for confirmation, section 1129(b). The concepts are separate and distinct, each serving a specific function in the formulation and confirmation of a plan. When applied to the facts of a particular case, however, the concepts are interdependent and may overlap. For example, "permissible proposals" may be permissible "means of execution," but they must still meet the requirements for confirmation. Also permissible proposals must usually be acceptable to creditors. On the other hand, some mandatory requirements for confirmation may be circumvented if creditors accept the plan. The reader is advised to study the Code sections cited in the next section carefully.

1. *Time for Filing*

There are a number of conditions affecting when and who can file a plan.¹⁰⁶ In a typical voluntary case, the debtor has the exclusive right to file a plan for the first 120 days after the filing of the petition. The debtor then has an additional 60 days following the 120 days within which to obtain assent to the plan before it loses its right to plan exclusivity. Other persons (including a trustee, shareholders' committee, or creditor) may file a plan only if a trustee has been appointed, the debtor has not filed a plan within the 120 days, or the debtor has not had his plan accepted within 180 days of the date of filing the petition. The court can, for cause, reduce or increase the 120 or 180 day period within which the debtor has plan exclusivity and in which he may solicit acceptances of the plan. In more complex cases, these time periods are not realistic and courts frequently extend the limitations. It is also significant to note that there is no absolute requirement that the

106. 11 U.S.C. § 1121.

debtor file a plan within 120 days from the date of the order for relief. Rather, the debtor may take as long as is needed (provided there is no unreasonable delay)¹⁰⁷ risking only the exclusive right to file the plan.

2. *Classification of Claims or Interests*

A fundamental concept regarding the plan is the classification of claims or interests. A plan must designate different classes of claims or interests. However, as provided in section 1122, "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class."¹⁰⁸ A plan can designate a class of small unsecured creditors as necessary for administrative convenience as an exception to this rule. All other claims must be classified with the exception of certain post-petition administrative expenses.¹⁰⁹

The designation of these classes is critical to obtaining consent and confirmation of the plan. Section 1129(a)(8) requires that each class of claims accept the plan or be unimpaired. Classes should be designated in a manner that maximizes the possibility of meeting the voting requirements for acceptance.¹¹⁰ A list of possible classes of claims is contained in Appendix II.

3. *Impairment of Classes*

The plan must specify classes of claims or interests that are not impaired under the plan. Unimpaired claims are those that will not be extended, modified, or lessened in duration or amount.¹¹¹ The plan also must specify the treatment of any class of claims or interests that is impaired under the plan.¹¹² For example, the treatment of claims may specify that unsecured creditors will take 50 cents on the dollar over five years, secured creditors will roll back the interest rate four percent and accept lesser payments for three years, or that stock will be issued. Also, each member of a particular class must be treated the same; there can be no discrimination among members of a particular class.

107. 11 U.S.C. §§ 1112(b)(2),(3).

108. 11 U.S.C. § 1122(a).

109. 11 U.S.C. § 1123(a).

110. See text accompanying notes 124-26 *infra*.

111. 11 U.S.C. §§ 1124, 1123(a)(2).

112. 11 U.S.C. § 1123(a)(3).

4. *Means of Execution*

After specifying the classes and showing exactly how they will be impaired or unimpaired under the plan, the plan must set out in detail the means of executing the plan.¹¹³ This can be the truly creative process of a Chapter 11. A debtor's attorney has virtually unlimited leeway in being creative and providing a unique solution to the debtor's problems.¹¹⁴ The means for the plan's execution can include, among others, retention by the debtor of all or part of the property of the estate, merger or consolidation of the debtor with one or more entities, satisfaction or modification of liens, issuance of securities in exchange for claims or interest, or sale or lease of property not necessary to the business.

In the event securities are to be issued, nonvoting equity securities are prohibited, and such a prohibition must be in the charter of the debtor corporation.¹¹⁵

In cases where the debtor seeks to remain in possession but wishes to liquidate most of his property, section 1123(b)(4) allows for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interest.

F. *Disclosure Statement*

1. *Code Requirements*

Filing the plan does not alone give the proponent the right to solicit acceptances of the plan from the various classes of creditors.¹¹⁶ Prior to the solicitation of acceptances it is mandatory for the plan proponent to obtain court approval of a disclosure statement containing "adequate information."¹¹⁷ Adequate information is defined as:

information of a kind and in sufficient detail, as far as is reasonably practical in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan¹¹⁸

The concept of a disclosure statement is similar to that found

113. 11 U.S.C. § 1123(a)(5).

114. See text accompanying notes 97-99 *supra*.

115. 11 U.S.C. § 1123(a)(6).

116. 11 U.S.C. § 1125.

117. 11 U.S.C. § 1125(b).

118. 11 U.S.C. § 1125(a).

in securities law, but the bankruptcy court is not subject to the same rigorous standards the Securities and Exchange Commission may apply. As the Code points out, "whether a disclosure statement contains adequate information is not covered by any otherwise applicable nonbankruptcy law, rule or regulation" ¹¹⁹ Thus, similar to security law theory, the bankruptcy court does not actually review the plan before it is submitted to the creditors for vote. It simply reviews the adequacy of the information to insure that the creditors' vote is based on competent information.

The reason for the requirement of this disclosure statement is the "safe harbor" provision. If a plan proponent complies with the Code provisions by furnishing adequate information in the written disclosure statement approved by the court, the proponent is "not liable . . . for violation of any applicable law, rule, or regulation governing the offer, issuance, sale, or purchase of securities." ¹²⁰ This exemption from the intricacies of the securities laws is premised upon the bankruptcy court's duty to require disclosure of adequate information.

2. *Adapting the Statement to the Creditors*

What is adequate information therefore depends on the types of creditors to whom the statement is directed and their sophistication and knowledge. A different disclosure statement may be tailored for a particular class of claims. ¹²¹ For example, a class of secured creditors or a class whose claims center on a particular asset would have no use for a detailed description of other matters not concerning them.

Many creditors will require interpretive information with which to evaluate the meaning of the statement with regard to the plan. Attorneys preparing disclosure statements should provide evaluation information that describes "the bottom line" and plainly states risk factors for less sophisticated creditors. If some classes' acceptances do not have to be solicited, the information particularly relevant to those classes can be omitted. ¹²²

A comprehensive checklist for the possible contents of disclosure statements is contained in Appendix III to this article. ¹²³ One

119. 11 U.S.C. § 1125(d).

120. 11 U.S.C. § 1125(e).

121. 11 U.S.C. § 1125(c). As a practical matter in small cases, only one disclosure statement is prepared.

122. See text accompanying note 126 *infra*.

123. The checklist was obtained from and is printed with the permission of the Honorable John L. Peterson, Judge, United States Bankruptcy Court of the District of Montana.

preparing a disclosure statement will, of course, select elements from the list appropriate for the business and its creditors.

G. *Acceptance of Plan*

In most cases in which a plan is confirmed, all classes of claims or interests have accepted the plan. The requirements for class acceptance of the plan are contained in section 1126 of the Code. There is no requirement that every creditor and stockholder approve a plan for the plan to become operational.¹²⁴ A class of claims has accepted a plan when a majority in number and two-thirds in amount of those claims *actually voting* on the plan approve the plan.¹²⁵ The significance of the voting requirements must be noted. In some Chapter 11 proceedings creditor apathy is widespread. Under those circumstances, the interests of nonvoting creditors may easily be overcome by smaller but more active creditors. Also, if a class is left unimpaired under the plan, the class is deemed to have accepted the plan and solicitation of acceptances with respect to that class is not required. Similarly, a class is deemed not to have accepted a plan if the plan provides that the claims or interests of the class are not entitled to any payment or compensation under the plan.¹²⁶

H. *Confirmation of Plan*

1. *Code Requirements for Confirmation*

There are two basic methods for obtaining plan confirmation.¹²⁷ The more common method is obtaining the acceptances of all classes of claims. The second method is confirmation over the objection of creditors, the so-called "cramdown."¹²⁸ Under either method, a number of general requirements must be met.¹²⁹ The proponent of the plan and the plan must comply with the applicable provisions of Chapter 11. The plan must be a good faith plan and not proposed by any means forbidden by law. There must be a full disclosure of payments for services or for costs and expenses in connection with the plan and incident to the case. The payments

124. 11 U.S.C. § 1226(c).

125. 11 U.S.C. §§ 1226(c),(d). Acceptance of the class computed on the basis of those actually voting is a significant change from requirements under old Chapter X of the Act. S.R. No. 95-989, 95th Cong., 2d Sess. 122 (1978). The full text of the Senate Report is reprinted at 1978 U.S. CODE CONG. & AD. NEWS 5787-962.

126. 11 U.S.C. §§ 1226(f), (g).

127. 11 U.S.C. § 1129(a).

128. 11 U.S.C. § 1129(b).

129. Section 1129(a) lists 11 requirements that will not be separately cited.

must be fixed by the court as reasonable. The plan must disclose the identity and affiliation of those who are to serve as officers and directors of the new entity. Insiders who will participate in the reorganized debtor must be disclosed together with their compensation. If the debtor is subject to a regulatory commission with jurisdiction over the rates of the debtor, that commission must approve any rate change provided in the plan.

The more complex provisions of section 1129(a) insure that dissenting members are protected by the "best interests of creditors" test.¹³⁰ This test basically means that dissenting members of a class will receive payments under the plan which are not less than would be received if the debtor were liquidated under a Chapter 7 proceeding. Under the first method of confirmation, each class must accept the plan or be unimpaired.

Payments of administrative expenses are a little known requirement for confirmation.¹³¹ Administrative expenses and certain "gap" expenses from involuntary cases have to be paid in cash on the effective date of the plan. Also, priority claims for wages, salaries, commissions and employee benefit plans, along with unsecured claims for deposits left for services or goods that were not delivered or provided, must receive deferred cash payments of a value as of the effective date of the plan equal to the amount of their claim. If these creditors have not accepted the plan, they must be paid in cash on the effective date of the plan. Priority tax claims may be paid over a period not exceeding six years, but the payments must have a present value equal to the amount of the claim. At least one class of claims must accept the plan, and this determination must be made without including any acceptance by insiders holding a claim. Finally, the plan must show some viability. If it appears that the confirmation of the plan is not likely to be followed by a liquidation or the need for further financial reorganization, the court may approve the plan.

2. *Confirmation over Objection of Creditors*

All requirements of section 1129(a) apply to confirmation by cramdown under section 1129(b) except the requirement that each impaired class accept the plan.¹³² The basic provision provides that a court must confirm the plan notwithstanding the requirement of class unanimity, "if the plan does not discriminate unfairly, and is

130. 11 U.S.C. § 1129(a)(7).

131. 11 U.S.C. § 1129(a)(9).

132. 11 U.S.C. § 1129(b). Confirmation under section 1129(b) eliminates the requirement of class acceptance in section 1129(a)(8).

fair and equitable, with respect to each class of claims or interest that it is impaired under, and has not accepted, the plan."¹³³

The determination of whether a plan is fair and equitable with respect to a class is set forth with specific statutory guidelines.¹³⁴ There are tests to be applied to secured claims, unsecured claims and ownership interests to determine whether the "fair and equitable standard" is met for each of them. The cramdown provisions are complex and fraught with difficulty. Complete articles have been devoted to the subject.¹³⁵ The following paragraphs describe some examples of the application of section 1129(b).¹³⁶

Suppose a class contains one secured creditor with a \$30,000 mortgage against a piece of real property, and the mortgage has been in default over a period of time. The plan can provide that the mortgage claimant retains a lien on the property. Although the claimant may be entitled to immediate payment in full under the terms of the note and mortgage, the plan can impair his rights by providing that the claimant receive deferred cash payments totaling at least the allowed amount of the claim as of the effective date of the plan. Assuming that the real property is worth \$30,000, the mortgagee could theoretically be compelled to accept \$12,000 a year for four years, provided that sum equals the present value of the mortgagee's interest.

If a class of secured claims does not consent, the secured property can be sold subject to section 363(k) with liens to attach to the proceeds of sale, and the lien can be treated the same as before. The secured party can be forced to take deferred cash payments equal to the present value of the amount of the lien. A plan may propose that the members of a dissenting class realize the "indubitable equivalent" of their allowed secured claims.¹³⁷ A replacement lien on collateral that is similar to the original collateral would suffice. However, unsecured notes or stock are not the "indubitable equivalent" of a secured claim.

With respect to classes of unsecured claims and ownership interests, the cramdown potential is initially similar to that of se-

133. 11 U.S.C. § 1129(b)(1).

134. 11 U.S.C. § 1129(b)(2).

135. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979); Blum, *The "Fair and Equitable" Standard For Confirming Reorganizations Under the New Bankruptcy Code*, 54 AM. BANKR. L.J. 165 (1980).

136. These examples and others are further illustrated in 3 COLLIER PAMPHLET, *supra* note 28, at 519-30.

137. 11 U.S.C. § 1129(b)(2)(A)(iii).

cured creditors.¹³⁸ The plan may provide that the holder of a claim will receive property of a value as of the effective date of the plan, equal to the allowed amount of the claim. By using the concept of present value, later payments are discounted and the class will receive the equivalent of cash upon confirmation. Alternatively, the plan can provide for any treatment of a class so long as no junior claim or interest will retain any claim against or interest in the debtor. In other words, a dissenting class must be provided for in full before any junior class can receive anything. An example of a junior class is a group of trade creditors who agreed to subordinate their claims to another group of trade creditors who continue to supply the debtor with goods. If a group of unsecured claims is the lowest in priority and the claimants reject the plan, cramdown is possible because there is no one lower on their priority list. If, however, the subordinated trade creditors are above equitably subordinated insider loans, and if the plan calls for payments to the equitably subordinated loans, then the trade creditors will be allowed to block the plan if they are not paid in full.

Testing to confirm a plan over the dissent of a class of equity security holders¹³⁹ is similar to that for unsecured claims. If one of two tests is met, the class can be crammed down. The plan may provide that the holder of an interest receive property of a value, as of the effective date of the plan, equal to the greatest of (1) the allowed amount of any fixed liquidated preference to which such holder is entitled, (2) any fixed redemption price to which its holder is entitled, and (3) the value of such interest. Common stock is usually not entitled to a redemption price or liquidation preference. Thus, in most cases, a class can only receive the value of their ownership interests. Often the value of the common stock is zero and there need be no provision in the plan for payment.¹⁴⁰

The plan may also provide that any interest that is junior to the interest of a class of stock will not receive any property. This means that the class can receive nothing under the plan provided subordinate interests do not refuse some type of preference. Remember, however, that even though this may be accomplished, the plan may not "discriminate unfairly," and must remain "fair and equitable."

138. 11 U.S.C. § 1129(b)(2)(B).

139. 11 U.S.C. § 1229(b)(2)(C).

140. See 3 COLLIER PAMPHLET, *supra* note 28, at 529.

I. *Effect of Confirmation*

Confirmation discharges the debtor from all its pre-petition debts except as provided in the plan and section 1141(d).¹⁴¹ Additionally, the plan terminates all the rights and interests of the equity security holders and general partners provided for by the plan.¹⁴² The plan does not discharge an *individual* from debts excepted from discharge under section 523.¹⁴³ This section should be familiar to most practitioners as the exception to discharge provision in liquidations. Also, a confirmation does not discharge a debtor if the plan liquidates and discontinues the business, and if the debtor would have been denied a discharge under section 727.¹⁴⁴ Thus, a corporation cannot receive a discharge upon utilization of a liquidating plan.

IV. CONCLUSION

As hard times in Montana continue, Montana businessmen and attorneys will look more to Chapter 11 as a means for resolving their problems. Chapter 11 is certainly not a panacea for the ills of every business. It provides a comprehensive and complex framework for restructuring liabilities and allowing a once profitable business to weather a period of recession. It also provides a forum for negotiation between the debtor and his creditors. The starting point for such negotiations is the recognition that the debtor and his creditors have parallel interests and that both can benefit substantially from a successfully reorganized business.

Montana attorneys must be cautious, however, in making the decision to proceed under Chapter 11. The nonlegal aspects of the business must be scrutinized. When the business has little potential for turnaround, the lawyer may be doing a great disservice to his client by attempting a Chapter 11 reorganization. When a thorough investigation of the debtor and his business is undertaken prior to any Chapter 11 proceedings, the attorney can save both himself and his client a good deal of wasted expense and effort in many instances. In a number of Montana Chapter 11 cases this has not occurred, to the detriment of all concerned.

When, however, there is a reasonable prospect of rehabilitation, Chapter 11 can provide the means for such rehabilitation. The debtor remains in business, his creditors receive more than

141. 11 U.S.C. § 1141(a).

142. 11 U.S.C. § 1141(c).

143. 11 U.S.C. § 1141(d)(2).

144. 11 U.S.C. § 1141(d)(3).

they would in a straight liquidation, and workers remain employed. When Chapter 11 is used under these circumstances, the purpose of Congress is achieved and the debtor, creditors, shareholders and the community receive the benefits.

APPENDIX I**Plan Proposals**

- (1) All classes of claims are impaired.
- (2) Issuance of non-negotiable, non-interest bearing impaired creditors' notes to become payable on sale of debtor's assets, with or without security interest given for payment of notes.
- (3) Interest bearing non-negotiable impaired creditors' notes.
- (4) Classes ordered in relative importance to the business with higher priority claims receiving full payment before other classes receive payment.
- (5) Certain classes to be cashed out and therefore unimpaired.
- (6) Certain classes to receive deferred cash payments in lump sums or installments, with or without interest.
- (7) Appointment of disbursing agent, custodian or trustee for payment of claims as property is sold, with or without bonding.
- (8) Retention of lien or transfer of lien to equivalent property.
- (9) Sale of property subject to liens free and clear with liens transferred to proceeds.
- (10) Increased interest rates on loans in exchange for waiver of default.
- (11) Curing default, reinstatement of contract.
- (12) Payments of a certain amount made by debtor each month to custodian for distribution to unsecured creditors pro rata periodically.
- (13) Sale of exempt property with consent of debtor.
- (14) Bringing interest on loan current while deferring principal payments.
- (15) Paying off short-term high interest loan first then paying off long-term loans.
- (16) Sale of collateral with liens attaching to proceeds; no deficiency, no interest.
- (17) Sale of inventory and other property not essential to reduced business operation.
- (18) Sale of homestead property; homestead exemption to capitalize new business entity.
- (19) Business conducted on reduced scale.
- (20) Sale or lease of real estate not essential to business.
- (21) Repossession of collateral in full satisfaction of secured claims.
- (22) Leaving judgment lienors unimpaired by reducing other en-

cumbrance on real property; deferred payment to judgment lienors.

- (23) Issuance of stock in reorganized entity.
- (24) Bonding of debtor.
- (25) Accelerated payments on one debt.
- (26) Reduction in amount of claims to 50% or less.
- (27) New lines of credit.
- (28) Reduction in salaries of managing debtors.
- (29) Subordination of insider loans.
- (30) Sale of portion of the business to insider.

APPENDIX II**Possible Classes of Claims**

- (1) Administrative expenses for which claims have been filed and allowed.
- (2) Claims having priority under section 507 other than administrative expenses.
- (3) Claims having priority under sections 507(3), (4), and (5).
- (4) Section 507(6) tax claims.
- (5) Disputed priority claims.
- (6) Judgment lienors.
- (7) Secured claims in certain property to be sold.
- (8) Secured claims separated into classes for differential treatment.
- (9) Unsecured claims of less than \$1,000 which are filed and allowed.
- (10) Unsecured claims of greater than \$1,000 which are filed and allowed.
- (11) Subordinated claims allowed under section 510.
- (12) Claims subordinated by agreement.
- (13) All secured claims of one creditor.
- (14) Contingent or disputed unsecured claims.

APPENDIX III

Suggested Contents of a Disclosure Statement

- (1) Short history of the business activities of the debtor;
- (2) General nature of the business transacted and to be transacted by the debtor;
- (3) Complete description of capital structure, including authorized and outstanding amounts of stock, number and classes of shares, and par value thereof, description of voting rights and other properties of the stock;
- (4) Names and addresses of all persons owning more than 10 percent of any class of stock and the percentage so held;
- (5) List of parents and subsidiaries;
- (6) Complete description of business:
 - (a) Competitive conditions in the industry and the debtor's competitive condition,
 - (b) Dependence upon one or more customers,
 - (c) Principal products and services,
 - (d) Methods of distribution,
 - (e) Current backlog and comparable figures for the previous year,
 - (f) Source and availability of raw materials,
 - (g) Significance of patents, trademarks, licenses, franchises and concessions,
 - (h) Importance and scope of research and development activities,
 - (i) Number of persons employed,
 - (j) Seasonal nature of business,
 - (k) Foreign operations,
 - (l) Governmental regulatory problems,
 - (m) Working capital position,
 - (n) Tax consequences,
 - (o) Income and profit figures for each line of business and each class of similar products or services;
- (7) Description of current and anticipated legal proceedings;
- (8) Description of securities being issued;
- (9) Information regarding officers and directors:
 - (a) Name, age, position held and duration,
 - (b) Familial relation with other officers or directors,
 - (c) Remuneration, including salaries, benefits and stock options;
- (10) Options outstanding;
- (11) Financial statements;

(12) Transactions with insiders and conflicts of interest:

(a) Full particulars of the nature and extent of the interest of every director, principal executive officer, and of every stockholder holding more than 10 percent of the stock (either of a class or in the aggregate) in any property acquired not in the ordinary course of business of the debtor within two years preceding the filing of the disclosure statement,

(b) Description of management contracts and of contracts made in other than in the ordinary course of business,

(c) Loans made to any director, officer or stockholder;

(13) Information concerning recent changes affecting revenues and expenses:

(a) Changes in product mix,

(b) Changes in advertising, research, development, product introduction or other discretionary costs,

(c) Acquisition or disposition of a material asset other than in the ordinary course of business,

(d) Material extraordinary charges or gains, including charges associated with discontinuation of operations,

(e) Material changes in assumed investment return,

(f) The closing of a material facility or other material interruption, or completion of a material contract, or any event that will materially reduce revenues in subsequent periods;

(14) Other information where necessary:

(a) Projections where required,

(b) Risk factors,

(c) Nondischargeable debts,

(d) Secrets of management,

(e) Attorney fees for debtor and plan proponent.