The Ten Commandments of Chapter 11:
Thou Shalt Invite Failure by Ignoring These Rules

BY ROCCO I. DEBITETTO

Using the pages of the *ABF Journal* in place of two tablets of stone, Attorney Rocco Debitetto hands down the Ten Commandments of Chapter 11.

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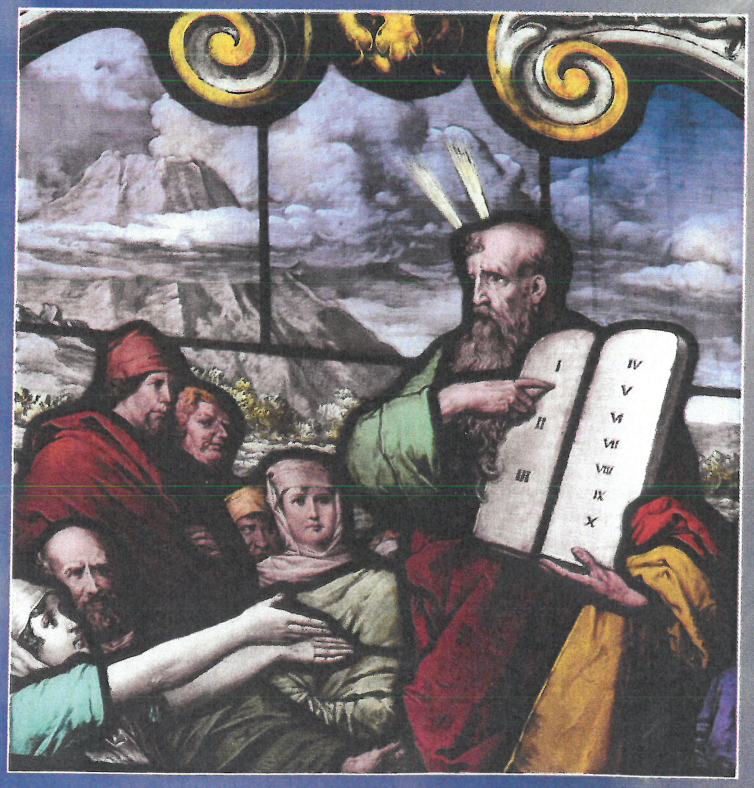
Rules are the core of any religion. As a practicing Catholic, I appreciate the certainty these rules provide. For example, I'm not allowed to pass on a game of bingo, especially one played at an all-you-can-eat fish fry[1] (throw in a silent auction, and it's a recipe for decisions leaving one portly and broke — all for a good cause if it helps pay for a new scoreboard in the gym). I also appreciate the Ten Commandments. Irrespective of any particular faith, they're pretty solid rules to live by. For example: Don't murder. Got it. Don't steal. Check. Don't covet other people's stuff. **Wow**, my neighbor just bought a **really nice** car. Damn. Pretty simple, right? Chapter 11 should be no different.

[Cue the lightning and thunder.]

Like a poor-man's Moses, I ascended Mt. St. Insolvency, returning with these Ten Commandments of Chapter 11. So drop that U.C.C. you're holding — it's apocryphal compared to the almighty Bankruptcy Code — and pay attention. > >

1 I haven't found the exact citation in the Bible yet, but I'm substantially certain it's there.



I. Thou shalt respect the automatic stay.

When a debtor files bankruptcy, an automatic stay takes effect, prohibiting creditors from taking any action affecting the debtor or estate property.[2] If you think this is broad, you're right. Also, if you think about violating the stay, think again. It's not a congressional suggestion, but a mandate — so much so that willful violations of the automatic stay expose creditors to fee awards, actual damages and even punitive damages.[3]

II. Thou needn't show mercy to co-debtors.

Despite its breadth, the automatic stay in Chapter 11 does not prohibit creditors from taking actions to enforce rights against those that didn't file bankruptcy. Guarantors, co-borrowers and their respective property are fair game. Be wary, however, that unbridled pursuits of third parties might unintentionally alienate a debtor, particularly if the targets are officers tasked with making decisions affecting the debtor's business or exit strategy.

III. Thou shalt be mindful of seized property.

Secured lenders, particularly inventory financiers, frequently face the issue of what to do with repossessed collateral in their possession or control when the borrower files bankruptcy. The short answer is — nothing (unless you want to violate the First Commandment).

Estate property includes "all legal or equitable interests of the debtor in property as of the commencement of the case[.]"[4] This also encompasses property seized by a creditor *before* the bankruptcy filing.[5] If you're faced with holding or controlling seized collateral, it's best to obtain relief from the automatic stay before exercising your rights with respect to such property. Moreover, if it appears you will suffer "irreparable harm" due to the automatic stay (*e.g.*, if the collateral is perishable), then request immediate relief from stay without a hearing.[6]

Judicial perception is particularly crucial in large Chapter 11 cases, which can span several months (or years), and where credibility trades like currency.

2 11 U.S.C. § 362(a).
3 11 U.S.C. § 362(k)(1).
4 11 U.S.C. § 541(a)(1).
5 *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205-06 (1983).
6 11 U.S.C. § 362(f).

IV. Thou shalt file a proof of claim timely and carefully.

Although there are limited instances in which lenders need not file a proof of claim in order to preserve voting and distribution rights, better practice is always to file a proof of claim in a timely manner in every bankruptcy case. It is the easiest way to place the debtor and third parties on notice of your claim amount and collateral. There are two caveats:

First, remember that a proof of claim can and will be used against you. Don't include anything in it that is unsubstantiated or that you are not prepared to support. A prime example is collateral value, which can come back to help (or haunt) creditors in connection with other matters such as in seeking relief from the automatic stay (where it is helpful to be under-secured), or in claiming post-petition interest, (where you must be over-secured).

Second, by filing a proof of claim, creditors subject themselves to bankruptcy court jurisdiction and might compromise rights to a jury trial. Particularly where lenders suspect the debtor might assert counterclaims, they should carefully weigh all options with counsel before filing a proof of claim.

V. Thou shalt wear the white hat.

Everybody's hat is white on the first day of a case, but only you can keep yours that way. Smart lenders will always ask their attorneys to explain how every action will influence a court's overall perception of them and their cause. Judicial perception is particularly crucial in large Chapter 11 cases, which can span several months (or years), and where credibility trades like currency. Not to say you shouldn't be aggressive, but you should avoid actions that could be construed as chicanery or unnecessary saber rattling.

VI. Thou shalt leverage cash collateral and DIP financing orders.

A secured lender's leverage is greatest at the start of the case, when the debtor needs the use of cash collateral or additional debtor-in-possession financing to survive. If you're inclined to support either, then make certain your consent is conditioned on several, if not all, of the following:

- Allowance of your pre-petition claim and acknowledgement of valid, perfected pre-petition liens
- A deadline for third parties, such as any creditors' committee, to challenge your pre-petition liens and claims or to assert claims against you, after which such challenges and claims are barred
- Replacement liens in post-petition collateral[7]
- An acceptable cash collateral budget, including adequate protection payments to you (*e.g.*, monthly interest)[8] and, if you're over-secured, reimbursement of your own fees and costs[9]
- A grant of "super priority" liens and administrative claims, taking precedence over all others[10]
- A waiver of collateral surcharge rights[11]
- Strict reporting/information sharing requirements for the debtor such as weekly cash flow statements comparing actual to projected use of cash, or requiring debtor to share all LOIs from buyers or plan sponsors
- Acknowledgement and preservation of credit bid rights, irrespective of whether they are exercised in a stand-alone sale or pursuant to a plan of reorganization[12]
- A deadline to propose a plan or sale acceptable to you
- Automatic relief from stay if the debtor defaults under any obligation to you.

VII. Thou shalt implement a litigation hold.

Although a bankruptcy case is not a traditional lawsuit, it usually gives rise to litigation. Lenders should implement appropriate litigation holds preventing the destruction, alteration or mutilation of potentially relevant evidence like credit files or communications with a debtor. In view of the Fifth Commandment, think about how a court would receive this deposition excerpt: "Q: Did you produce all responsive documents in discovery? A: No. Q: Why? A: Because we — we — you see, a bunch of stuff was thrown out."

VIII. Thou shalt see value in committee support.

One of the most influential players in Chapter 11 is the unsecured creditors' committee. It's also an inherent adversary of secured lenders, though it needn't remain that way. By strategically aligning with the committee, you gain the advantage of being pals with the other big kid on the block. There's no formula for accomplishing this, and it's not always possible. Nevertheless, keep thinking of ways your interests are or can be aligned and, if any come to light, make the most of it. Remember, too, that a carve-out is the old-fashioned way to win a committee's heart.

IX. Thou shalt listen to thy debtor.

This can be the hardest commandment to follow because, ordinarily, the debtor's business judgment precipitated the bankruptcy. It's surprising nevertheless how many creditors altogether ignore the debtor's views on topics like market climate, the best exit strategy or meaningful sources of value. You needn't *agree* with the debtor on everything; just don't fall prey to tunnel vision or axe-grinding, which usually leads to protracted litigation and value-offsetting costs.

X. Thou shalt see value in competent estate professionals.

Whether it's an attorney, financial advisor or CRO, competent estate professionals can make or break any case. If your debtor proposes retaining a reasonable lineup of reputable professionals, don't resist. You're just passing through Bankruptcyland, but they're full-time residents with tremendous incentive to see a case succeed. If runaway fees are a concern, remember that unless a flat fee is approved up front with their retention, you'll always have the right to object to an estate professional's fee application later.

While following these commandments isn't going to guarantee the perfect outcome in Chapter 11, ignoring them will invite failure. Fortunately, it's not the eternal kind, though you might have trouble besting your neighbor's ride by flubbing a bankruptcy case and blowing your year-end bonus. But don't worry if you do. I'm certain there's an all-you-can-eat fish fry within walking distance, and it just takes five balls to win. abfj

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7 11 U.S.C. § 361(2).
8 11 U.S.C § 361(1).
9 11 U.S.C. § 506(b).
10 11 U.S.C. § 364(b), (c).
11 11 U.S.C. § 506(c).
12 11 U.S.C. § 363(k).