

Chapter 11, Five Cards at a Time: Secured Lenders Hold ‘Em or Bust

BY ROCCO I. DEBITETTO

To Hahn Loeser & Parks Partner Rocco I. Debitetto, navigating Chapter 11 is like playing a hand of no-limit Texas Hold ‘Em. By understanding the fundamentals of the popular poker variation relying on mathematically and psychologically correct decisions, secured lenders can control the money pot. First move: Take stock of who’s at the table, evaluate their interests and envision their strategies.

“The beautiful thing about poker is that everybody thinks they can play.”

— Chris MoneyMaker, professional poker player



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Chapter 11 is like a hand of no-limit Texas Hold ‘Em, only without ESPN fanfare. The game is simple. Each player is dealt a two-card hand. Thereafter, the dealer reveals five “community” cards by way of the “flop” (three cards simultaneously revealed), followed by the “turn” (the fourth card) and ending with the “river” (the final card). Players use the community cards to build their best five-card hand, betting after each phase. Like life, the fill of your coffer is the only limit on how much you can bet. In the end, the best hand wins — everybody else just tries to lose less than the next schmuck. If secured lenders understand Hold ‘Em, they can understand Chapter 11.

The Pre-Flop

Your borrower files Chapter 11. Two cards glide across worn green felt, stopping before you. What’s first?

All players study their own hand. *Good* players study everything else first. They observe who’s at the table, where they’re sitting and how they react to the cards. Are they playing with Johnny Chan or Clark Griswold? Did their opponent look at the cards and giggle like an accountant on April 16th, or grimace like a loan originator on January 1st? Studying everybody else helps determine what’s next. So it goes in Chapter 11.

When a case is filed, quickly take stock of who’s at the table, evaluate their interests and envision their strategies, then answer these questions:

- Is there senior or junior debt, and where do you fall in the pecking order?
- Who are the largest trade creditors; are any particularly influential on operations, and is there potential for a creditor committee?
- Where is the case filed, and what is your experience with the jurisdiction?

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- Is management in place and trustworthy?
- What professionals were retained, and what is their expertise and reputation?
- What’s the status of the borrower’s industry?

These questions should not be difficult, particularly for asset-based lenders. They’ll help you develop the landscape of the case. Now it’s time to peek at your hand by answering some more questions:

- What’s the loan balance, and how significant is the credit overall?
- Is the balance over- or under-secured based on known or reasonably ascertainable collateral values?
- Is the loan properly documented, and are liens properly perfected?
- Is there any unencumbered collateral?
- Do you have any recent budgets or cash-flow projections, and what do they tell you?
- Is there any preference exposure for transfers of property (or interests in property) made to you, or perfected by you, within 90 days before the bankruptcy?
- Are there non-debtor co-borrowers or guarantors, and what is their status?

With this information, you’re ready for what’s next.

The Flop

The flop is Hold ‘Em’s defining moment. Good flops clobber you, sometimes causing a Cheshire grin to creep slowly across the face of one enjoying the catbird seat. Bad flops reinforce everything you ever thought about karma. Enough of them in a row, and you’ll excuse yourself from a game long enough to call old flames and apologize for whatever earned you a ticket to Dumpsville (population: you). The worst flops are the ones lost somewhere in between — the ones that make you think it just might be worth committing another few bucks to the hand.

That’s typically where you’ll find yourself in Chapter 11. But now you’re armed. You wisely tuned out your Eeyore-like credit officer long enough to appreciate the strengths and weaknesses of your hand, and are ready to address them head on with the flop. The flop in Chapter 11 comes in three general categories: Cash Collateral/Financing, Information Gathering and Other Leveraging. > >

Cash Collateral/Financing

Most debtors request court authority to use (your) cash collateral to operate. A debtor also may request authority to obtain priming DIP financing either from you on a consensual basis, or from a third-party over your objection. Remember this: Without the use of cash, the debtor's hand is *over*; without DIP financing, the debtor's hand is *likely over*.

Although the debtor may not use cash collateral or prime pre-petition liens without "adequately protecting" your pre-petition interests, for example, through replacement liens in post-petition collateral, liens on new collateral or periodic cash payments, the urgency of cash needs creates an opportunity to obtain protections and concessions that are beyond "adequate."

In addition to traditional adequate protection, seek to include the following items in any cash collateral or DIP financing order:

- A finding that the loan balance is valid and that corresponding liens are valid and properly perfected.
- A budget including adequate protection payments to you. If you're over-secured, thus entitled to recover your fees and expenses, include them in the budget too. Your lawyer will thank you.
- A waiver of claims to surcharge you for preserving or disposing of your collateral.
- A deadline for parties, especially a creditor committee, to challenge pre-petition liens and claims or otherwise assert claims against you.
- Strict reporting requirements (e.g., daily/weekly cash-flow statements).
- Acknowledgement and preservation of your credit bid rights at any sale, irrespective of whether conducted pursuant to a plan or stand-alone sale motion.
- A definitive exit strategy, such as an agreed-upon plan of reorganization or sale, and tight benchmark deadlines.
- Immediate relief from the automatic stay if the debtor defaults in post-petition obligations.

Don't overplay your hand and kill the case, unless the debtor is worth more dead than alive. Great players holding the best possible hand (aka the "nuts") keep others in the game long enough to maximize returns.

Information Gathering

In Hold 'Em, the more information you have, the better off you are. Chapter 11 is no different. Study whatever information comes across your desk, financial or otherwise. Look for inconsistencies in anything the debtor says or reports, and hypothesize what's transpiring behind the scenes. Typically a theme will emerge that you can develop and leverage. But don't stop with whatever information the debtor volunteers. There are other opportunities to mine information:

- Attend the initial meeting of creditors. Take copious notes and ask as many questions as are permitted.
- Examine the debtor or related parties under Bankruptcy Rule 2004. These exams are court-sanctioned fishing expeditions — literally.

You may be surprised how you can strengthen your hand with information. Moreover, where debtors have something to hide, a well-timed examination request may cause them to fold in the face of a bad loss.

Other Leveraging

Don't underestimate the impact of exercising other leverage points in a case. For example, if management is incompetent or dishonest, consider filing a motion to appoint a Chapter 11 trustee. Few things get attention faster than seeking to hit "eject" on management. Be sure, however, to consider carefully whether a trustee is ultimately your friend or foe, and understand that requesting a trustee rings a bell that cannot be un-rung.

Consider also challenging the debtor's exclusive right to propose a plan, which expires 120 days after the petition date. Object to any extension of exclusivity and insist on co-exclusivity with the debtor. Co-exclusivity begins to level the playing field.

Ultimately, whatever you do during the flop, don't overplay your hand and kill the case, unless the debtor is worth more dead than alive. Great players holding the best possible hand (aka the "nuts") keep others in the game long enough to maximize returns.

The Turn

The turn is underappreciated. Most players have a decent strategy for the pre-flop and flop, but no real game plan beyond that. Don't be that player.

In Chapter 11, the turn involves setting an exit strategy into motion. If things went smoothly during the flop, by now you already know how the turn should look. If not, then you're probably facing a sale or plan of reorganization that might not be favorable. Remember these guidelines at the turn:

- Use the sale or plan process to settle unfinished business, such as open items on your demand list associated with cash collateral/financing.
- Try out new tools, such as credit bidding to drive up a purchase price or plan consideration; electing to have your entire claim treated as fully secured under a plan (an 1111(b) election), or proposing your own plan if the debtor's exclusive right to do so lapsed.
- Undertake a cost-benefit analysis to determine whether "tipping" the committee (giving unsecured creditors a finite amount of money) in exchange for its support is advisable.
- Be creative always.
- Don't be afraid to fold a bad hand.

The River

By the time you're on the river, there should very few surprises. You either have the nuts, figured out who has them (if you don't), or convinced yourself that the cash you're about to blow on an absurd bluff is a justified advertising expense for when you get the nuts later...realigned karma permitting.

It's not much different in Chapter 11 when you're heading toward consummating a sale or confirming a plan. You've either bounced everybody out of the case, or, perhaps more realistically, caused everybody to show their hands, and structured a deal that makes everybody happy (or at least equally sad). Try pulling that off in Vegas.

If, however, you find yourself in the unenviable position of praying for a miracle on the river, just remember that guarantors — especially personal ones — have a way of making magic just when you need it most.

I'd end by wishing you good luck, but luck, like karma, is in your hands. *abfj*

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