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### **CHAPTER 11 IN'S AND OUT'S**

I am honored that you have selected our office for the purpose of working with you to help resolve a financial crisis in your companies' life. The concern, worry and frustration that come from not knowing what to do to resolve a particular problem can create an extremely critical and fragile time in your life, one to which I am very sensitive. Thus, I will always attempt to make myself available to respond to your questions and provide information which may be needed and/or give legal advice.

While I realize that these pages may be lengthy, I urge you to take the time to read them and let me know of any questions that may arise. I am not presenting these pages to you as a substitute for legal advice and counseling, but only as an attempt to fill the gaps, if any exist. It will become evident that certain parts of this are more relevant to you than others; however, if you believe any part of this discussion is relevant and has not been covered when we meet to discuss your individual situation, I urge you to bring it to my attention.

#### **IF I ELECT TO FILE UNDER CHAPTER 11, WHAT IS MY ROLE AND WHAT IS YOURS?**

I view your role as that of someone earnestly and honestly seeking rehabilitation and restructuring of your company under Chapter 11; thus, you have two very distinct responsibilities to yourself, your company and me as your attorney:

1. Educate yourself.

You simply cannot approach Chapter 11 without having a basic knowledge as to how it works. This can only occur if you take the time to read this booklet, ask questions and be willing to tell me frankly when you do not understand.

As you will see, the concepts are straight forward and understandable if you take the time. Unless you inform me to the contrary, I will assume that you have the necessary knowledge to truly benefit from Chapter 11.

Please avoid "curbstone" advice. This is the type of advice a person receives from well-intending friends, relatives or just bystanders who have a story to tell about what happened to them or what happened to their second cousin. While there is no question that these people mean well, my experience has repeatedly shown that such advice is wrong or slanted because of some prejudice. If you feel inclined to act upon any such advice, please discuss it first with me to determine if it fits your particular situation.

2. Provide me with complete, accurate and honest information.

As we begin it is absolutely necessary for you to provide me irrefutable information. In addition to your moral obligation, you must provide accurate information for the following reasons:

- All documents that I prepare for you for filing under Chapter 11 will be signed by you under oath (you will swear to their accuracy).
- Failure to provide accurate information may result in your plan not being confirmed. It should be noted, however, that unintentional, honest mistakes can usually be corrected.
- Intentional misstatements in bankruptcy documents or false testimony may be a violation of Federal criminal laws that could result in a Federal indictment, prosecution, conviction, and imprisonment.

I will at all times assume that all bankruptcy information you provide me is totally accurate unless you advise me that a mistake has been made. Otherwise, I must decline to represent you.

My job is to educate you and to perform the mechanical functions necessary to accomplish your objective: your plan confirmation and fresh financial start. I agree to do so as quickly as possible in order to protect you from loss of assets, harassment or anything that represents an impediment to you in reaching your goal.

### **WHY IS BANKRUPTCY NECESSARY FOR MY COMPANY?**

Bankruptcy under Chapter 11 is the beginning of a new time for your company. It is a fresh financial start. It is, however, to be used only when no other remedies are available to resolve an economic problem. I would never recommend filing a Chapter 11 when there is sufficient disposable income for a plan to be structured to pay your creditors without the necessity of such drastic action.

While the action is drastic, it should never be considered an event so traumatic that it will leave a permanent scar or a stigma of any kind. There is nothing negative, in my opinion, about Chapter 11. To the contrary, it represents a positive statement by your company to allow a new financial day to be born so that, free from the monumental load which comes with financial problems, you can again handle your affairs with confidence.

I only urge you to make a positive statement about your company and make a decision to resolve your financial problem, as opposed to doing what our friend the ostrich does quite well, that is to stick his head in the sand when the enemy surrounds him and pretend the problem does not exist.

### **What Is Chapter 11?**

Chapter 11 is that part (or chapter) of the Bankruptcy Code that permits a person or business to obtain protection from its creditors while it attempts to reorganize, rehabilitate, or liquidate itself. Technically, Chapter 11 is Chapter 11 of the Bankruptcy Code, which is entitled "Reorganization." The Bankruptcy Code is that portion of the United States Code (i.e. the federal statutes) that deals with bankruptcy.

### **Who may file under Chapter 11?**

Legally, anyone except a governmental agency, an estate, a non-business trust, a stockbroker, a commodity broker, an insurance company, or a bank may file under Chapter 11. An individual may not file under Chapter 11 if he or she has had another bankruptcy case dismissed upon certain grounds within the last 180 days. As a practical matter, Chapter 11 is available to virtually any business or person able to afford the expenses of the case.

**Are there any financial or insolvency requirements for filing under Chapter 11?**

No. There is no financial or insolvency requirements for filing a voluntary Chapter 11 case. A voluntary Chapter 11 debtor may be solvent or insolvent, its assets may exceed its liabilities by any amount (or vice versa), and its income may be substantial or non-existent. The only financial restriction is the practical one of whether the cost of the case to the debtor is justified by the intended benefit. A voluntary Chapter 11 case is a Chapter 11 case filed by the debtor. An involuntary Chapter 11 case is a Chapter 11 case filed against the debtor by its creditors.

**What is a debtor?**

A debtor is a person or business concerning whom a case under the Bankruptcy Code has been commenced. A person or business that has filed a Chapter 11 case is referred to as a debtor.

**Are there any restrictions as to the size or type of business that may file under Chapter 11?**

No. A business filing under Chapter 11 may be very large, very small, or anywhere in between. Under Chapter 11, a business may be a sole proprietorship, a partnership, or a corporation of any size. Only those entities and persons listed in the answer to question 2 above are eligible to file under Chapter 11.

**Does a person have to be engaged in business to qualify for Chapter 11 relief?**

A person does not have to be engaged in business in the traditional sense to obtain Chapter 11 relief. A consumer is legally eligible to file under Chapter 11. As a practical matter, however, the person filing under Chapter 11 must have something to reorganize, rehabilitate, or liquidate before a Chapter 11 relief can be granted. A non-business debtor with substantial personal investments or assets may use Chapter 11 to reorganize or liquidate his or her investments or assets.

**What are the court costs in a Chapter 11 case?**

The Chapter 11 filing fee is \$850.00, which must be paid to the clerk of the bankruptcy court when the case is filed. In addition, there is a quarterly fee payable to the United States trustee that is based on the amount disbursed by the debtor in possession or trustee during a Chapter 11 case until such time as a plan is confirmed. The amount of the quarterly fee varies from \$250 to \$10,000 per quarter, depending on the amount disbursed. Current United States trustee fees are as follows:

**Chapter 11 Quarterly Fees Based on Disbursements**

Disbursement Range .....	Amount
\$0 to \$14,999.99 .....	\$325
\$15,000.00 - \$74,999.99 .....	\$650
\$75,000.00 - \$149,999.99 .....	\$975
\$150,000.00 - \$224,999.99 .....	\$1,625
\$225,000.00 - \$299,999.99 .....	\$1,950
\$300,000.00 - \$999,999.99 .....	\$4,875
\$1,000,000.00 - \$1,999,999.99 .....	\$6,500
\$2,000,000.00 - \$2,999,999.99 .....	\$9,750
\$3,000,000.00 - \$4,999,999.99 .....	\$10,400
\$5,000,00.00 to \$14,999,999.99 .....	\$13,000
\$15,000,000 to \$29,999,999.99 .....	\$20,000

\$30,000,000 or more..... \$30,000

**What is a United States trustee and what does it do in a Chapter 11 case?**

The United States trustee is an officer of the United States Department of Justice and serves independently of the bankruptcy court. The function of the United States trustee in a Chapter 11 case is to monitor the case, appoint one or more creditors' committees, call and preside at meetings of creditors, appoint a trustee in the case if ordered to do so by the bankruptcy court, and collect the quarterly fee. Generally, the United States trustee takes appropriate action to insure that all reports and documents are filed, that all fees are paid, and that there is no undue delay in the case. Most Chapter 11 debtors are required to make periodic (initial and monthly) financial and operating reports to the United States trustee during the course of the case, at least until a plan is confirmed. The United States trustee should not be confused with a trustee appointed in a Chapter 11 case to operate the debtor's business and take possession of the debtor's property. A trustee in a Chapter 11 case is appointed by the United States trustee, and is discussed in the answers to questions below (page 7).

**How much are the attorney's fees in a Chapter 11 case?**

The amount charged by an attorney for handling a Chapter 11 case for a small business debtor varies greatly depending on such matters as the size of the business, the type and extent of relief needed by the debtor, the attitude of the debtor's creditors, the type of reorganization needed or contemplated by the debtor, and whether the owners of the business are in agreement or disagreement as to how the business should be reorganized. Unless the case is a simple one, most attorneys charge on an hourly basis and require a retainer to be paid in advance. The total fee charged for handling a small business Chapter 11 case may vary from \$7,500.00 or less for a simple case to several times that amount for a complex case. All fees charged or collected by an attorney in connection with a Chapter 11 case, whether prior to or after the case is filed, must be approved by the bankruptcy court as being reasonable in amount.

**What type of immediate relief may a debtor obtain by filing under Chapter 11?**

The filing a Chapter 11 case automatically stays all foreclosures, collection actions, civil litigation, and creditor action of any kind against the debtor or the debtor's property. The only significant proceedings not stayed by the filing of a Chapter 11 case are criminal proceedings against the debtor and proceedings by governmental agencies to enforce police or regulatory powers. All other proceedings and acts against the debtor or the debtor's property, whether in or out of court, are stayed. Even telephone calls or the sending of letters or bills to the debtor, if for the purpose of collecting a pre-petition debt, are precluded by the automatic stay. An act or proceeding that is stayed is held in abeyance, and no further action may be taken in the matter without the approval of the bankruptcy court. As explained in the answer to questions below (page 11), the automatic stay that accompanies the filing of a Chapter 11 case normally gives the debtor a moratorium of several months on the payment of many of its bills and debts.

**What type of long-term relief may a debtor obtain under Chapter 11?**

Long-term relief in the form of either a reorganization of the debtor's business or an orderly, debtor-controlled liquidation of the debtor's assets may be obtained under Chapter 11. If the debtor's business is reorganized, it may continue to function either in its present form or in a revised form, and its present creditors will be permitted to satisfy their claims only as provided in the debtor's plan of reorganization. A reorganization may consist of anything from an extension of time for the repayment of debts to a total restructuring of the business.

### **How long does a Chapter 11 case last?**

A Chapter 11 case may be broken down into two phases: the pre-confirmation phase and the post-confirmation phase. The first phase, which is the phase prior to the confirmation of a plan, normally lasts from six to twelve months, although the time may vary depending on the condition of the debtor, the type of plan proposed by the debtor, and the reaction of creditors to the plan. The second phase normally lasts from three to five years, although it, too, may vary in duration. See the answer to questions below (page 11) for further reading on the length of the second phase of a Chapter 11 case, which is the phase where the confirmed plan is implemented and carried out by the debtor.

### **When does the debtor receive a discharge in a Chapter 11 case?**

In a Chapter 11 case the debtor receives a discharge when a plan is confirmed by the Court. The order of the court that confirms the plan also contains the debtor's discharge. A discharge is a court order relieving the debtor from liability for certain debts. A debt that is discharged is a debt for which the debtor is no longer liable, except as provided in the Chapter 11 plan.

### **What debts are discharged by a Chapter 11 discharge?**

The debts discharged in a Chapter 11 case depend on whether the debtor is an individual (i.e., a natural person), or a non-individual (i.e., a corporation, partnership, etc.). The discharge received by an individual debtor in a Chapter 11 case discharges the debtor from all pre-confirmation debts except those that would not be dischargeable in a Chapter 7 case filed by the same debtor. The discharge received by a non-individual debtor in a Chapter 11 case depends on whether the plan confirmed is a plan of reorganization or a plan of liquidation. The discharge received in the confirmation of a plan of reorganization discharges a non-individual debtor from all scheduled pre-confirmation debts without exception. However, if the plan confirmed is a plan of liquidation and if the debtor does not engage in business after consummation of the plan, a non-individual debtor does not receive a discharge.

### **Is a Chapter 11 discharge valid if the debtor later fails to carry out the plan?**

Yes. The validity of a Chapter 11 discharge is not affected by the subsequent failure of a debtor to consummate the plan. As long as the order of confirmation is not revoked by the Court (which seldom happens), the discharge received by the debtor in the order of confirmation is valid even if the debtor later fails to fulfill its obligations under the Chapter 11 plan.

### **How is a Chapter 11 case commenced?**

A voluntary Chapter 11 case is commenced by filing a voluntary petition with the clerk of the bankruptcy court requesting relief under Chapter 11 of the Bankruptcy Code. A number of other documents are usually filed with the petition. However, if it is necessary to file the case before the other documents can be prepared, most of the other documents may be filed within 15 days after the petition is filed. The \$830 filing fee must be paid when the petition is filed, unless a debtor who is an individual is unable to pay the entire filing fee at that time. Debtors who are unable to afford the entire filing fee when a Chapter 11 case is filed seldom succeed under Chapter 11.

### **Where is a Chapter 11 case filed?**

A Chapter 11 case is filed with the clerk of the bankruptcy court in the district where the debtor resides, has its principle place of business, or has its principal assets. The bankruptcy court for the Southern District of Texas, Houston Division is located at 515 Rusk Avenue, Houston, Texas 77002.

### **Is the public informed of the filing of a Chapter 11 case?**

When a Chapter 11 case is filed, all of the debtor's creditors, shareholders, partners, and other persons directly involved with the debtor are notified. Notice of a Chapter 11 case is not normally published in newspapers or trade journals unless the filing of the case is considered newsworthy by the newspaper or journal. Generally, only the creditors, owners, and employees of a small business debtor are aware that the debtor has filed a Chapter 11 case.

### **Does a person or business filing under Chapter 11 have to continue to pay its debts after the case is filed?**

Most Chapter 11 debtors receive a moratorium on the payment of most of their general unsecured debts for the period between the filing of the case and the confirmation of a plan. This period usually lasts for six to eight months. During this period it may be necessary for the debtor to pay creditors whose property, goods, or services are needed to continue the business operation.

### **How does a Chapter 11 case proceed after it has been filed?**

After a Chapter 11 case has been filed, the debtor must file documents with the court listing the names and addresses of all of its creditors and interest holders, describing all of its property and other assets, and disclosing other financial information about the debtor. The debtor, as a "debtor in possession," is usually permitted to continue to operate its business during the course of the case, but must comply with the requirements of Chapter 11 and the bankruptcy court in so doing. A creditor whose security is threatened may apply to the court for relief from the automatic stay or for adequate protection of its security interest. The debtor must prepare a Chapter 11 plan and file it with the court, usually within 120 days after the case was filed. The debtor must also prepare, file, and obtain court approval of a disclosure statement that adequately informs its creditors and interest holders of its financial condition and of its future plans. After the disclosure statement has been approved by the court, copies of the statement and the Chapter 11 plan are distributed to creditors and interest holders, who may then vote on whether to accept or reject the debtor's plan. If the plan is accepted by at least one class of creditors whose claims are impaired (i.e., not paid in full, see question below) under the plan, the plan may be confirmed by the court. After the completion of voting, a confirmation hearing is held wherein the court must decide whether to confirm the plan. If the plan is confirmed by the court it becomes effective and must be carried out and consummated by the debtor. When the plan is confirmed by the court, the debtor receives a Chapter 11 discharge. After the plan has been consummated, a final report is filed and the case is closed.

### **What is an interest holder and what is its role in a Chapter 11 case?**

An interest holder is the holder of an equity interest in the debtor. In Chapter 11 cases interest holders are often referred to as equity security holders. A shareholder is an interest holder of a corporation and a limited partner is an interest holder of a limited partnership. Individual and general partnership debtors do not have interest holders. If the rights of interest holders are dealt with in a Chapter 11 plan, interest holders are treated like creditors and are permitted to file proofs of their interests, vote on the acceptance or rejection of a plan, and participate in distribution under the plan. However, most plans in small business Chapter 11 cases deal only with creditors and do not deal with or affect the rights of interest holders.

### **What is a “debtor in possession” and what is required of it in a Chapter 11 case?**

A “debtor in possession” is the debtor in a Chapter 11 case in which a trustee has not been appointed. As a debtor in possession, the debtor is legally charged with the rights, duties, and obligations of a trustee holding the debtor’s property and operating the debtor’s business for the benefit of its creditors and interest holders. As a debtor in possession, the debtor must abide by the rules and standards of Chapter 11 and the orders of the bankruptcy court. The failure of a debtor in possession to perform its obligations and duties may result in the appointment of a trustee, a court order terminating the debtor’s business, the conversion of the case to Chapter 7 or the dismissal of the case.

### **What is cash collateral?**

Cash collateral is cash or property easily converted to cash. Property such as inventory, bank accounts, checks, securities, and other cash equivalents constitutes cash collateral. Because it is easily disposed of, the use or sale of cash collateral is subject to strict rules in Chapter 11 cases. The use or sale of cash collateral is discussed in the answer to a question below.

### **Is the debtor permitted to operate its business during a Chapter 11 case?**

Unless a trustee is appointed, the debtor may continue to operate its business during a Chapter 11 case as a debtor in possession. In operating its business during a Chapter 11 case, the debtor, as a debtor in possession, must abide by the requirements of Chapter 11 and the orders of the bankruptcy court.

### **What are the grounds for the appointment of a trustee in a Chapter 11 case?**

There are two grounds for the appointment of a trustee in a Chapter 11 case: a trustee may be appointed for cause, or if the appointment would be in the best interests of creditors. Cause for the appointment of a trustee includes, but is not limited to, fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or during the case. A trustee is not appointed in most Chapter 11 cases.

### **What happens if a trustee is appointed in a Chapter 11 case?**

If appointed, the trustee assumes most of the management functions of the debtor’s business and takes control of the debtor’s property. In effect, the trustee will replace the debtor’s current management in the operation of the debtor’s business during the course of the Chapter 11 case. The trustee may also assume control over many aspects of the debtor’s chapter 11 case. When a trustee is appointed in a Chapter 11 case, the debtor ceases to be a “debtor in possession.”

### **What limitations are placed on a debtor’s right to use, sell, or lease its property during a Chapter 11 case?**

For purposes of use, sale, or lease during a Chapter 11 case, a debtor’s property is divided into two categories: cash collateral, and all other property. During the case, the debtor, as a debtor in possession, may not use, sell, or lease cash collateral unless each creditor secured by the cash collateral consents to the proposed use, sale, or lease, or unless the court approves the proposed use, sale or lease. Unless the court orders otherwise, the debtor may use, sell, or lease any of its property except cash collateral in the ordinary course of business during the case without prior notice to creditors or court approval. The debtor may use, sell, or lease property other than cash collateral outside the ordinary course of business during the case only after notice to any affected creditors and a court hearing.

### **May the debtor incur new debts and obtain new credit during a Chapter 11 case?**

Yes. Unless the court orders otherwise, the debtor, as a debtor in possession may obtain unsecured credit and incur unsecured debt in the ordinary course of business during a Chapter 11 case without court approval. Further, the unsecured credit or debt so obtained or incurred is payable as an administrative expense in the case, which means that those creditors get paid ahead of all other unsecured creditors. Court approval is required prior to obtaining or incurring any other type of credit or debt during the case. Thus, secured credit or unsecured credit not in the ordinary course of business may be obtained during the case only with the prior approval of the bankruptcy court.

### **May the debtor break its contracts or leases in a Chapter 11 case?**

Yes. Under Chapter 11, the debtor, as a debtor in possession, may, at its option and without the consent of the other party, reject, assume, or assign most contracts or leases under which the debtor is obligated. This may be done either by motion during the Chapter 11 or as part of a Chapter 11 plan.

### **What is a disclosure statement?**

It is a document prepared by the proponent of a Chapter 11 plan that discloses to creditors and interest holders financial and other information about the debtor and the proposed plan sufficient to enable them to make an informed decision on whether to accept or reject the proposed plan. The court must approve a disclosure statement before it is distributed to creditors and interest holders.

### **What is a Chapter 11 plan?**

It is a document that shows how the debtor will deal with its creditors and interest holders. A Chapter 11 plan may be very simple or very complex, but it must comply with the legal requirements of Chapter 11. Most Chapter 11 plans are plans of reorganization, but a Chapter 11 plan may also be a plan of liquidation.

### **How may secured creditors be dealt with in a Chapter 11 plan?**

Much depends on whether a creditor is fully secured or partially secured. The claim of a fully secured creditor must be paid in full in cash, and if deferred cash payments are made on the claim, interest must be paid to the creditor. A partially secured creditor may elect to have its claim treated as being fully secured, and if such an election is made the claim must be paid in full in cash, but if deferred cash payments are made, interest does not usually have to be paid on the claim. If a partially secured creditor does not elect to have its claim treated as being fully secured, the secured portion of its claim must be paid in the same manner as a fully secured claim, while the unsecured portion may be paid as an unsecured claim.

### **What is the difference between a fully secured creditor and a partially secured creditor?**

A fully secured creditor has a claim that is secured by a valid lien on property of a value that equals or exceeds the amount of the claim. A partially secured creditor has a claim that is secured by a valid lien on property of a value that is less than the amount of the claim. For example, if a creditor is owed (i.e., has a claim for \$5,000 and if the claim is secured by a first mortgage on property valued at \$5,000 or more, then the creditor has a fully secured claim. If the same creditor with the same claim is secured by a first mortgage on property valued at \$3,000, then the creditor is partially secured, and has a \$3,000 secured claim and a \$2,000 unsecured claim. Thus, a partially secured creditor actually has two

claims, one secured and the other unsecured. In a Chapter 11 case, a partially secured creditor may elect to have its claim treated as being fully secured by exercising what is called a Section 1111(b) election.

### **How may unsecured creditors be dealt with in a Chapter 11 plan?**

The answer depends on whether a creditor has a priority or a non-priority claim. Priority claims must be paid in full in cash under a Chapter 11 plan, unless a creditor agrees otherwise. Further, all priority claims except tax claims must be paid when the plan is confirmed or shortly thereafter, unless a particular creditor agrees otherwise. Tax claims may be paid in deferred cash payments with interest over a period not exceeding six years from the date of assessment of the tax. An unsecured creditor with a non-priority claim must be paid at least as much as the creditor would have received had the debtor filed under Chapter 7, and payment need not be in cash. Non-priority claims may be paid in cash, property, or securities of the debtor or the successor to the debtor under the plan.

### **How does a priority claim differ from a non-priority claim?**

A priority claim is unsecured claim that is given priority of payment under the Bankruptcy Code. Priority claims include the following types of claims: the administrative expenses of the Chapter 11 case, wage claims of up to \$4,000 per employee, wage benefit claims of employees up to certain limits, consumer deposit claims of up to \$1800 each, and unsecured tax claims. Administrative expenses include the fees of debtor's attorney and unsecured credit or debt incurred in the ordinary course of operating the debtor's business during the case. A non-priority claim is a general unsecured claim incurred by the debtor prior to the filing of the Chapter 11 case.

### **May someone other than the debtor propose and file a Chapter 11 plan?**

Yes, but only under certain conditions. The debtor has the exclusive right to file a Chapter 11 plan for the first 120 days after the filing of a voluntary Chapter 11 case, unless a trustee is appointed during the 120-day period. If the debtor files a plan during the 120-day exclusive period, the debtor must gain acceptance of its plan by creditors and interest holders within 180 days after the case was filed in order to retain the exclusive right to file a plan. In summary, a party other than the debtor may file a plan if a trustee is appointed in the case, if the debtor fails to file a plan within 120 days after the case was filed, or if the debtor fails to gain acceptance of a plan within 180 days after the case was filed.

### **Who may file a Chapter 11 plan if the debtor fails to do so?**

If any of the conditions describe in the answer to the previous question occur entitling a party other than the debtor to file a Chapter 11 plan, any party to the case may file a plan, including a creditor, an interest holder, or a creditors' committee.

### **What is a creditors' committee?**

It is a committee appointed by the United States trustee that represents the interests of creditors in the case. In most small business Chapter 11 cases the only committee appointed is the unsecured creditors' committee, which represents the interests of non-priority unsecured creditors in the case. The unsecured creditors' committee is usually composed of the seven largest unsecured creditors who are willing to serve on the committee.

### **What must a creditor do to become entitled to payment in a Chapter 11 case?**

For a creditor to be entitled to payment in a Chapter 11 case, the creditor's claim must be filed and must be allowed by the court. If a creditor's claim is listed in the schedules filed by the debtor in the case, and is not listed as being disputed, contingent, or unliquidated, then the claim is considered to be filed in the case. Otherwise, a creditor must file a document called a "proof of claim" in order for its claim to be filed. Once a claim is filed, either by virtue of being included in the debtor's schedules or by the filing of a "proof of claim", the claim is automatically allowed by the court unless someone files an objection to the allowance of the claim, in which case the court must hold a hearing to determine whether to allow the claim. Thus, if a creditor's claim is correctly listed in the debtor's schedules and if no one files an objection to the claim, the claim is automatically allowed in the case even if the creditor does nothing.

### **When do creditors vote on whether to accept or reject a Chapter 11 plan?**

Voting on a plan begins after the court approves the disclosure statement prepared by the party proposing the plan. Each eligible creditor is mailed a ballot for voting on the plan. The ballot is accompanied by a copy of the disclosure statement and a copy or summary of the proposed plan. The court sets a deadline for voting on the plan, and a creditor's ballot must be filed with the court prior to the voting deadline in order to be counted.

### **What creditors are eligible to vote on the acceptance or rejection of a Chapter 11 plan?**

Creditors must qualify both individually and by class in order to be permitted to vote on the acceptance or rejection of a plan. Individually, a creditor's claim must be allowed by the court in order to be eligible to vote. The allowance requirements for claims for purposes of voting are the same as the allowance requirements for purposes of payment, and are described in the answer to the question above. Except for certain priority claims, a Chapter 11 plan must put each claim in a class. To be eligible to vote on the acceptance or rejection of a plan, a class of claims must be impaired by the plan and must receive something under the plan. For a class of claims to be impaired by a plan, at least one claim in the class must be impaired under the plan. Classes of unimpaired claims are presumed to have accepted the plan and classes of claims receiving nothing under the plan are presumed to have rejected the plan. Creditors in these classes of claims do not vote on the acceptance or rejection of a plan. Creditors with allowed claims in all other classes of impaired claims are eligible to vote on the acceptance or rejection of a plan.

### **What is an impaired claim?**

An impaired claim is a claim that is impaired by a Chapter 11 plan. A claim is impaired by a plan if the rights of the creditor to enforce its claim are diminished or materially changed by the plan. A claim that is not paid in full under a plan is an impaired claim. Even if a claim is paid in full under a plan, the claim is considered to be impaired if the original maturity date or any other obligation contained in the agreement upon which the claim is based is not met by the plan. Under Chapter 11, a debtor is permitted to cure a defaulted note, mortgage, or other obligation so that the creditor's claim is no longer impaired. A defaulted obligation is cured and not impaired if the obligation is made current, the creditor is compensated for any expenses incurred by reason of the debtor's default, and the rights of the creditor under the obligation are thereafter unaltered.

### **How is it determined whether a plan is accepted or rejected by creditors?**

All voting on the acceptance or rejection of a plan is by class. The creditors in each class of impaired claims vote on whether the plan will be accepted by that class of claims. To be accepted by a

class of claims, a plan must be accepted by creditors holding at least two-thirds in amount and one-half in number of the claims in the class that actually vote on the acceptance or rejection of the plan. At least one class of impaired claims must vote to accept a plan before the plan can be confirmed by the court.

### **What happens when a plan is confirmed by the court?**

To become legally effective, the bankruptcy court must confirm a Chapter 11 plan. A plan is confirmed by the bankruptcy court when the bankruptcy judge signs an order approving the plan and ruling that the debtor and all creditors and interest holders are bound by the provisions of the plan.

### **When and under what circumstances may a plan be confirmed by the bankruptcy court?**

After creditors and interest holders have voted on whether to accept or reject a proposed Chapter 11 plan, the bankruptcy court will hold a hearing for the purpose of determining whether to confirm the plan. This hearing is called the confirmation hearing. At the confirmation hearing, the party proposing the plan, which is usually the debtor, must present evidence showing that the plan complies with the Chapter 11 confirmation requirements. A plan may be confirmed by the court either through the regular confirmation method or through a “cram down.” The regular method of confirmation is used when the plan has been accepted by every class of creditors with impaired claims and interest holders. The cram down method of confirmation is used when the plan has been rejected by one or more classes of creditors with impaired claims of interest holders, but has been accepted by at least one class of creditors with impaired claims. A plan that has not been accepted by at least one class of creditors with impaired claims cannot be confirmed by the court.

### **How does confirmation of a plan under a “cram down” differ from the regular method of confirmation?**

When every class of creditors with impaired claims and every class of interest holders has voted to accept a plan and confirmation is sought under the regular confirmation method, there are 13 legal requirements that must be satisfied in order for the plan to be confirmed by the court. When confirmation of a plan is sought under a cram down, in addition to satisfying each of the 13 confirmation requirements except the requirement that the plan be accepted by every class of impaired claims and interests, it must be shown that the plan does not discriminate unfairly against any class or interests that has not accepting the plan and that the plan is fair and equitable with respect to each class of claims for interests that has not accepted the plan. For a plan to be deemed fair and equitable with respect to a non-accepting class of claims or interests, the plan must meet certain legal requirements that are too complicated to be explained here. It is more difficult to obtain confirmation under a cram down than under the regular confirmation method.

### **What happens if the court does not confirm a Chapter 11 plan?**

If the court decides not to confirm a Chapter 11 plan, it will usually permit the party proposing the plan to modify the plan so that it may be confirmed. If a Chapter 11 plan is modified, it is usually necessary to hold another confirmation hearing on the modified plan. If the court refuses to confirm any plan, the Chapter 11 case must either be dismissed or converted to Chapter 7.

### **What happens after a Chapter 11 plan has been confirmed by the court?**

After the Court has confirmed the Chapter 11 plan the plan must be implemented and carried out by the debtor. If the plan calls for the debtor to be reorganized or for a new corporation to be formed, this function must be varied out. If the plan calls for property to be transferred or for liens to be created or

modified, this must also be done. And of course, the claims of creditors must be paid in the manner specified in the plan.

**For how long a period may a Chapter 11 plan run?**

There are no specific limits on the length on a Chapter 11 plan. A Chapter 11 plan must be long enough to convince the court and creditors that the debtor is making a good faith effort to pay as much of its debt as is realistically possible. On the other hand, the plan must not be so long that it does not appear feasible to the court. Most Chapter 11 plans of small business debtors are from three to five years in duration.

**What happens if the debtor is unable to comply with or carry out the provisions of a plan after it has been confirmed by the court?**

If the debtor, or the successor to the debtor under the plan, is unable to comply with the provisions of a confirmed plan, the plan may be amended so that it can be complied with, if sufficient grounds exist for such an amendment. Otherwise, the Chapter 11 case may be dismissed or converted to Chapter 7. If the debtor, or the successor to the debtor under the plan, fails to carry out its obligations under the plan, creditors may sue, or foreclose on the property of the debtor or its successor either in the bankruptcy court or in other courts.

**What happens when all of the provisions and requirements of a Chapter 11 plan have been carried out?**

When all of the provisions and requirements of a Chapter 11 plan have been fulfilled or carried out, the plan is said to have been consummated. When a plan has been consummated, a final report and accounting must be filed and the court will close the case.