ASPEN CASEBOOK SERIES

LEVITIN

BUSINESS BANKRUPTCY
Financial Restructuring and Modern Commercial Markets

Wolters Kluwer

ASPEN CASEBOOK SERIES

BUSINESS BANKRUPTCY

Financial Restructuring and Modern Commercial Markets

ADAM J. LEVITIN
Professor of Law
Georgetown University Law Center

Wolters Kluwer

Published by Wolters Kluwer in New York.

Wolters Kluwer serves customers worldwide with CCH, Aspen Publishers, and Kluwer Law International products. (www.wolterskluwerlb.com)

To contact Customer Service, e-mail customer.service@wolterskluwer.com, call 1-800-234-1660, fax 1-800-901-9075, or mail correspondence to:

Wolters Kluwer
Attn: Order Department
PO Box 990
Frederick, MD 21705

Printed in the United States of America.

1 2 3 4 5 6 7 8 9 0

ISBN 978-1-4548-5802-7

Library of Congress Cataloging-in-Publication Data

Levitin, Adam Jeremiah, author.
Business bankruptcy: financial restructuring and modern commercial markets / Adam J. Levitin, Professor of Law Georgetown University Law Center.
pages cm. — (Aspen casebook series)
ISBN 978-1-4548-5802-7
1. Business failures — Law and legislation — United States. 2. Bankruptcy — United States. 3. Corporate reorganizations — United States. 4. United States. Bankruptcy. Chapter 11, Reorganization. I. Title.
KF1544.L48 2015
346.7307'8 — dc23

2015025340

About Wolters Kluwer Law & Business

Wolters Kluwer Law & Business is a leading global provider of intelligent information and digital solutions for legal and business professionals in key specialty areas, and respected educational resources for professors and law students. Wolters Kluwer Law & Business connects legal and business professionals as well as those in the education market with timely, specialized authoritative content and information-enabled solutions to support success through productivity, accuracy and mobility.

Serving customers worldwide, Wolters Kluwer Law & Business products include those under the Aspen Publishers, CCH, Kluwer Law International, Loislaw, ftwilliam.com and MediRegs family of products.

CCH products have been a trusted resource since 1913, and are highly regarded resources for legal, securities, antitrust and trade regulation, government contracting, banking, pension, payroll, employment and labor, and healthcare reimbursement and compliance professionals.

Aspen Publishers products provide essential information to attorneys, business professionals and law students. Written by preeminent authorities, the product line offers analytical and practical information in a range of specialty practice areas from securities law and intellectual property to mergers and acquisitions and pension/benefits. Aspen's trusted legal education resources provide professors and students with high-quality, up-to-date and effective resources for successful instruction and study in all areas of the law.

Kluwer Law International products provide the global business community with reliable international legal information in English. Legal practitioners, corporate counsel and business executives around the world rely on Kluwer Law journals, looseleafs, books, and electronic products for comprehensive information in many areas of international legal practice.

Loislaw is a comprehensive online legal research product providing legal content to law firm practitioners of various specializations. Loislaw provides attorneys with the ability to quickly and efficiently find the necessary legal information they need, when and where they need it, by facilitating access to primary law as well as state-specific law, records, forms and treatises.

ftwilliam.com offers employee benefits professionals the highest quality plan documents (retirement, welfare and non-qualified) and government forms (5500/PBGC, 1099 and IRS) software at highly competitive prices.

MediRegs products provide integrated health care compliance content and software solutions for professionals in healthcare, higher education and life sciences, including professionals in accounting, law and consulting.

Wolters Kluwer Law & Business, a division of Wolters Kluwer, is headquartered in New York. Wolters Kluwer is a market-leading global information services company focused on professionals.

To Sarah for everything.
You deserve all the credit.

PREFACE

The aim of this book is to provide an overview of the modern financial restructuring process. In so doing, the book aims to revitalize the traditional bankruptcy course with a healthy dose of "bankruptcy realism." By this I mean that my goal is to provide a book that can be used to teach bankruptcy law as it actually lives in a broader legal ecosystem.

Bankruptcy realism has three components. First, it means teaching bankruptcy law as but one piece of the restructuring puzzle (even if it is the most important piece). My goal in this book is to broaden the scope of "bankruptcy law" as taught in law schools to include more than the in-court Chapter 11 restructuring process.[1] The traditional bankruptcy course is focused on big-B Bankruptcy lawyering, meaning representing either debtors or creditors in litigation in Chapter 11 cases (or in consumer bankruptcy cases in Chapters 7 and 13). The traditional bankruptcy course largely ignores the small-b bankruptcy lawyering, including the transactional work in Chapter 11 cases, as well as out-of court restructurings and bankruptcy-influenced transaction design.

The traditional big-B conception makes for a coherent class, but is, in my view, too narrow. It presents bankruptcy as a stand-alone process divorced from the non-bankruptcy world. I want students to come away from the course seeing how bankruptcy fits with non-bankruptcy restructuring. Chapter 11 is a very powerful tool, but it is not the only one in the restructuring toolbox. The importance of bankruptcy as a system can only be understood once one understands the legal limitations of out-of-court restructurings. At the same time, what is possible in out-of-court restructurings as a practical matter is shaped by the parties' knowledge of what could happen in bankruptcy. Accordingly, the law of out-of-court restructuring, including private contractual limitations in loan syndications and securitizations, the Trust Indenture Act, and exit consent solicitations are properly part of the bankruptcy course, rather than a topic for a corporate finance class.

A second component of bankruptcy realism is teaching bankruptcy law as including not just the actual restructuring of financially distressed companies, but also transactions shaped by bankruptcy concerns. Thus, a second goal of this book

1. This broader vision of bankruptcy law is not just a Chapter 11 issue. In another book, I make a parallel move relating to consumer finance, which prior to the creation of the CFPB was largely the bailiwick of consumer bankruptcy scholars, who examined the consumer finance system through the bankruptcy system, in part because of the availability of rich empirical data. The creation of the CFPB should underscore that bankruptcy filing is an exceptional behavior for consumers. Most consumers in financial distress do not file for bankruptcy, and most consumers are not in financial distress at any given time. Instead, the consumer finance system needs to be examined holistically from the front-end, not from the back, and not just from a consumer perspective, but from consumer, business, and regulatory perspectives.

is to introduce students to modern financial transactions and products that are shaped by bankruptcy law: asset securitization, repos and derivatives, syndicated loan structures and intercreditor agreements, intercompany guaranties, and leveraged buyouts. Just as small-b bankruptcy is properly part of a restructuring course, so too are transactions structures that are heavily driven by bankruptcy concerns.

In my experience, law students are desperately thirsty to understand complex modern financial transactions. They know that they'll encounter some, if not all, of these transactions in practice, and that law school is the only place they will get a systematic overview of the transactions. Unfortunately, despite the ubiquity of complex financing transactions, they receive no reliable coverage within the law school curriculum, yet they are vitally important to the world of practice students are preparing to enter. If these transactions are covered at all in law school, it is usually only passingly in secured credit or corporate finance classes. All too often, secured credit classes are hyper-focused on the details of UCC Article 9 at the expense of considering either actual deal documents or the dynamics of the modern lending marketplace, which no longer fits the model of local bank making a Main Street loan. To understand both mega- and middle-market lending, one needs to understand the transactional structure and institutional framework of these financial products.

The typical bankruptcy course touches on these transactions only to the extent necessary to explain bankruptcy law issues, such as the scope of the automatic stay or fraudulent transfers. This book gives these topics much more emphasis. The goal in this regard is to provide students with an introduction to what these products are and how they are shaped by bankruptcy law; this is not a text about financial product regulation. Because these transactions are all shaped by bankruptcy concerns, bankruptcy attorneys are often involved in these transactions, just as they are in out-of-court restructurings. Hopefully students will come away from this book with a sense of the broader world of what bankruptcy attorneys do and what bankruptcy law affects beside Chapter 11 itself.

The third component of bankruptcy realism is teaching the reality of modern business bankruptcy practice. Too often bankruptcy courses present a collection of restructuring principles and theories applied haphazardly to both consumer and business debtors without systematic treatment of bankruptcy practice's non-statutory features that are perhaps more important than statute in shaping restructurings. While there is "one Code to rule them all" the issues, economics, policies, and often statutory provisions involved in consumer bankruptcies are fundamentally different from those involved in business bankruptcies. The combined consumer-business bankruptcy course is the standard offering in American law schools, but I do not think it does a favor to either consumer or business bankruptcy to try to cover both topics in a single course. Both topics are sufficiently rich and complex to merit their own courses.

This book confines itself to business bankruptcies, and it attempts to provide a view of the Chapter 11 process that reflects the realities of modern Chapter 11 reorganizations. This is an aim that is intimately connected with understanding modern financial transactions and the institutional participants therein. Thus, topics such as bankruptcy sales, including sales procedures, valuation issues and methodologies, first-day orders and DIP lending agreements, and claims trading

and responses such as lock-up agreements, are given more extensive and integrated treatment than in existing texts. I have attempted to incorporate excerpts from actual transactional documents as much as possible so that students actually get some experience reading these real documents. Likewise, I have tried to provide more "color" about what is really going on in bankruptcy cases through the use of case studies that position particular bankruptcy issues within larger transactional fights.

It's impossible to cover everything in a casebook of reasonable (or publishable) length, much less in a 3- or 4-credit course. Obviously some things have to get cut. Bankruptcy jurisdiction and international coordination didn't make it. Bankruptcy jurisdiction gets some attention regarding venue and jurisdiction over personal injury and wrongful death claims, but bankruptcy jurisdiction is largely a federal courts topic (although largely ignored by federal courts scholars). Chapter 15 coordination issues are again a set of jurisdictional issues. Executory contracts get shorter shrift than in other texts. They are covered, but I do not believe that a deep dive into the morass of section 365 is worth the coin. Likewise, all the twists and turns of section 547(c) get limited coverage, despite being beloved of law professors for creating exceptions to exceptions, thus providing great exam questions. A final area that gets scant attention are the issues relating to the retention and regulation of bankruptcy professionals. For a practitioner these are quite important, but they are largely quite unrelated to understanding the system of financial restructuring and the transaction structuring that occurs in its shadow.

Adam J. Levitin
August 2015

ACKNOWLEDGEMENTS

I owe a debt of gratitude to many people for helping see this book to fruition. First, my teachers, without whom I would never have fallen in love with the world of credit and finance: Martin Bienenstock, Richard Levin, Mark Roe, and especially Elizabeth Warren. I was fortunate to have had such an extraordinary and inspirational group of teachers when I was in law school, and know that if I had not been assigned to Elizabeth's 1L Contracts class, my life would have been entirely different. My 1L section assignment is a serendipity I cherish, even if this book eschews of Elizabeth's approach to teaching consumer and business bankruptcy together. I hope she will see my approach as exactly the sort of a challenge a good teacher hopes to encourage in her students.

One of the joys of my job is how I get to keep learning, and colleagues have played no mean part in this. Bill Bratton provided the most generous mentoring to me when I joined Georgetown as a junior professor. Bill was the one who made me first aware of the Trust Indenture Act and its background without which the absolute priority rule never really made sense, and Bill's avuncular wisdom in regarding corporate finance and scholarly and institutional norms was invaluable. I hope I can pass it on. Bob Thompson not only took over Bill's office, but also picked up on all aspects of the mentoring with unmatched patience. He is a treasured colleague, and I am in his debt. David Kuney and Peter Friedman, both part of Georgetown Law's amazing roster of adjunct faculty, provided valuable suggestions, infused with the knowledge gained from practice.

My co-bloggers at Credit Slips, particularly Bob Lawless, John Pottow, and Stephen Lubben, have all been fantastic and good-humored sounding boards on a range of bankruptcy issues, as has Ted Janger, who has engaged me with enthusiasm ever since I was a pup on the academic job market. And my Georgetown colleague and co-blogger Anna Gelpern has been my kindred comrade and friend in the academy ever since we created our very own Frankenstein. As she knows, I'm still working on Marshal Budyonnii.

My colleagues from my brief time in practice at Weil Gotshal, particularly Rachel Erlich Albanese, Ronit Berkovich, Sara Coelho, Harvey Miller, Chris Mirick, and Andrew Troop, have continued to be resources for me, as has Emil Kleinhaus. I am grateful for their time.

Several research assistants have helped along the years in assembling the materials that are now in this book: Ari Dropkin, Robert Enayati, Grant McQueen, Galena Petrova, and Anna Sandor. I am grateful for their hard work, as I am for the help of my faculty assistants Cynthia Rockwell and Roger Bourcicot. Additionally, students at Georgetown and Harvard served as unwilling guinea pigs for draft versions of this book, and their feedback, and, in some cases detailed line edits, helped improve the manuscript.

My editors at Wolters Kluwer have also worked to make this book a reality. In particular, Richard Mixter, Cindy Uh, and Tom Daughhetee helped shepherd this book to fruition. Comments from several reviewers also saved me from (at least some) embarrassing mistakes. Thomas Plank's detailed comments on securitization structures were particularly helpful. All mistakes are, of course, my own.

My mother and father (*z''l*), brother and sister, and in-laws have always supported and encouraged my curiosity, even if they might not understand my particular interest in bankruptcy, and that is love.

Finally, the deepest of thanks to my family. This book was written on Sarah, Amalia, and Kalman's dime. You endured my chatter about bankruptcy and finance with generous patience and love, tolerated my eccentricities, and inspired me in my work. You are my happiness and are indubitably without equivalents. *A hartsikn dank.*

BUSINESS BANKRUPTCY

Financial Restructuring and Modern Commercial Markets

SUMMARY OF CONTENTS

CONTENTS