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ARTICLE

United States: Bradley's Bankruptcy Basics: Chapter 11 Bankruptcy — Reorganization

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Chapter 11 bankruptcy cases are most frequently filed by businesses. However, certain high-earning individuals whose debts are above the statutory debt limits to qualify for Chapter 13 can also file for Chapter 11 relief. In Chapter 11 cases, the debtor retains control of its operations as a debtor in possession (DIP) and has the benefits and duties that are held by a Chapter 7 trustee. However, if the debtor acts in bad faith or mismanages the bankruptcy estate during the course of the case, a Chapter 11 trustee may be appointed to operate the business going forward.

We've put together a [high-level overview or "lifecycle" of a Chapter 11 case](#), emphasizing concepts and milestones of particular importance for creditors. Additionally, we have created a [preliminary checklist](#) that will help you navigate the early stages of Chapter 11 bankruptcy.

Chapter 11 Plan

In addition to filing their schedules and statements, Chapter 11 debtors also file a plan that proposes to repay creditors, as well as restructure debts, reorganize business operations, and/or liquidate some or all of the debtor's assets. The benefit of receiving payment under a Chapter 11 plan, rather than a straight Chapter 7 liquidation, is that the debtor will pay more over the course of the plan as a result of its continued business operations than what it would otherwise pay creditors if they were simply paid by the proceeds from selling the debtor's assets. (In fact, this is a requirement for a Chapter 11 plan to be confirmed.)

Chapter 11 Plans Generally Supersede Prior Contracts

A Chapter 11 plan is essentially a change in terms agreement or modification that amends the terms of prior contractual agreements that creditors have with the debtor or a proposal that provides for payment of claims arising from judgments, fees, or other non-contractual obligations. Chapter 11 plans can also "assume" or "reject" leases or other "executory contracts" (contracts that are not yet completed) or "assume and assign" the leases or executory contracts to third parties. After a Chapter 11 plan is confirmed, the plan's terms bind all parties and override the terms included in prior agreements to the extent those agreements are not otherwise provided for and extended in the plan.

After a debtor files its proposed plan, creditors vote on whether to accept or reject it. The debtor must obtain a certain amount of votes accepting the plan for it to be confirmed. If one or more voting creditors rejects the plan, the debtor can still "cram down" the plan and have it confirmed over the rejecting creditor's objections. This can result in the debtor entering into side agreements with certain creditors and granting them better plan treatment than they might have otherwise received in exchange for the creditors' agreement to vote in favor of the plan and cram the plan down on dissenting creditors.

For its Chapter 11 plan to be confirmed, the debtor must also fulfill the statutory requirements set forth in Section 1129. More information about plan confirmation and objections to confirmation will be included in future blog posts.

Chapter 11 plans come in all shapes and sizes and often provide the most creative manner to repay as much as possible to as many creditors as possible. Plans can include reorganizing the debtor's business operations to cull waste, account for bad business decisions, and make greater profits in the future; restructuring debts to extend loan terms, change the amount or type of collateral, or change payment and interest rates; and selling the debtor's property and distributing the proceeds to creditors.

First Day Motions

Chapter 11 cases often move very quickly. While matters may not be as dire for smaller Chapter 11 debtors than those debtors with millions or billions in debt, many Chapter 11 debtors will file some "first day" motions, so called because they are filed almost immediately after the bankruptcy case is filed and hearings on them often occur within days of the bankruptcy case being opened. First day motions typically include motions to continue paying employees, motions to continue paying necessary vendors/suppliers, and motions to use cash collateral (i.e., cash in which creditors have security interests). The hearing on first day motions typically occurs within the first few days after the bankruptcy case is filed. Creditors will want to pay close attention to any first day motions that are filed, particularly motions to use cash collateral, and prepare to assert objections if necessary. More information about cash collateral and adequate protection will be provided in future blog posts.

Subchapter V

Chapter 11's new Subchapter V is a unique avenue for relief for small business debtors. Only debtors with debts less than approximately \$2.7 million qualify to file under Subchapter V. However, the CARES Act, which was passed in March 2020, temporarily increased this debt limit to \$7.5 million. This increase is currently scheduled to sunset on March 27, 2021; however, Congress is currently considering a bill to further extend the Subchapter V debt limit, as well as some other changes to the Bankruptcy Code that were included in the

Subchapter V debt limit, as well as some other changes to the Bankruptcy Code that were included in the CARES Act.

Like in other Chapter 11 cases, the Subchapter V debtor retains control of its business operations as a DIP. However, Subchapter V cases differ in a few ways from other Chapter 11 cases. For instance, only the debtor can file a plan in Subchapter V, whereas creditors can file plans that compete with the debtor's plan in regular

Chapter 11 cases. Additionally, in regular Chapter 11 cases, a plan can only be confirmed if a dissenting class of unsecured creditors is paid in full before any payments are made to the dissenting creditor's junior creditors. This is known as the "absolute priority rule." Subchapter V plans do not need to comply with the absolute priority rule to be confirmed. Subchapter V also provides for modification of certain mortgages on the debtor's principal residence where the proceeds of the mortgage were used in connection with the debtor's business.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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