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A CHECKLIST FOR CHAPTER 11 DISCLOSURE

By Dean E. Rietberg*

Before a Chapter 11 Plan of Reorganization can be submitted to creditors for balloting, the Court must first determine that the accompanying Disclosure Statement contains adequate information. 11 U.S.C. Section 1125(b). "Adequate information" is defined in Section 1125(a)(1) to mean "information of a kind and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan." Consistent with the legislative history to Section 1125, what actually constitutes adequate information in any particular case must be measured against the typical investor and determined case-by-case.

What follows in this article is not a treatise or annotation of what is deemed to be adequate information, but rather a structural outline or checklist for drafting or reviewing a Disclosure Statement. Nor do the guidelines that follow assert an official U.S. Trustee policy statement, but rather represent a compilation of both previously approved Disclosure Statements and the types of objections made by various parties that have generally been upheld by the judges in this district. This article should provide a foundation for the novice or "occasional" bankruptcy practitioner, including a creditor or committee considering the filing of a creditor's Plan, and a meaningful review for experienced counsel.

I. INTRODUCTION. The opening paragraphs of the Disclosure Statement should include the following basic information:

1. The date the Debtor filed its bankruptcy petition;

2. Whether the Debtor is operating as a Debtor in Possession or whether a Chapter 11 trustee was appointed;

3. The name of the party proposing the Disclosure Statement;

4. That a copy of the Plan of Reorganization is attached to the Disclosure Statement;

5. Who is being sent the Disclosure Statement;

6. The purpose of the Disclosure Statement (which is to provide its creditors, shareholders, and interested parties in this case with adequate information about the Debtor and its business to enable them to make an informed decision in exercising their rights to vote on the Plan);

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7. That the Disclosure Statement has been approved by the Bankruptcy Court and no other representations concerning the Plan are authorized;

8. The sources and degree of reliability of the information contained in the Disclosure Statement.

II. VOTING/CONFIRMATION PROCESS. Although creditors should be advised to consult their own legal counsel for guidance in voting on the Plan of Reorganization, the Disclosure Statement should nonetheless include the following general instructions:

1. Creditors need not be present in Bankruptcy Court to vote on the Plan;

2. Creditors may vote by completing the ballot attached to the Plan. Creditors should be directed to follow more specific instructions printed on ballot;

3. Ballots must be returned to the Clerk of Bankruptcy Court, P.O. Box 3310, Grand Rapids, MI 49501;

4. Ballots must be returned by the deadline stated;

5. The Bankruptcy Court will only consider the ballots actually submitted in determining whether to confirm the Plan;

6. Nevertheless, if the Plan is confirmed, the terms of the Plan will bind all creditors, regardless of whether they voted.

III. BACKGROUND. In order to view the Debtor's Chapter 11 proceedings from a historical perspective, the Disclosure Statement should include several paragraphs which:

1. Describe the Debtor's business;

2. Present a history of Debtor's operations;

3. Identify significant shareholders (if applicable);

4. Discuss the circumstances generally surrounding the Chapter 11 filing;

5. Identify the specific factors which immediately precipitated the Chapter 11 filing.

IV. CHAPTER 11 EVENTS AND OPERATIONS. Because the events during the Debtor's Chapter 11 proceedings will likely have a significant influence on voting decisions, this section of the Disclosure Statement should answer the following questions:

1. Generally, what has the Debtor been doing with estate assets during these months of Bankruptcy Court protection from its creditors?

2. What postpetition management and operational changes have the Debtor made?

3. What rulings has the Bankruptcy Court made in this case? (i.e., provide a brief procedural review of bankruptcy court events, including a discussion of any motions for sales, relief from stay, adequate protection, use of cash collateral, the appointment of a Chapter 11 trustee or examiner, and conversion to Chapter 7);

4. What specific changes has the Debtor made to resolve problems which necessitated the Chapter 11 filing?

5. What is the Debtor's current financial condition and what financial trends have been observed during the Chapter 11?

V. SUMMARY/DESCRIPTION OF CHAPTER 11 PLAN. Although the Plan of Reorganization will be mailed to creditors with the Disclosure Statement, the Disclosure Statement should nonetheless include a section which:

1. Summarizes the classifications of claims and their treatment (including the treatment of postpetition administrative expenses, such as current accounts payable, lease payments, unpaid professional fees (estimate if necessary), and statutory U.S. Trustee and Bankruptcy Court fees);

2. Discusses the means of implementation of the Plan (if the Plan is being funded by someone other than the Debtor, detailed information to demonstrate the funder's financial ability to complete its duties and obligations must be shown);

3. Describes current or anticipated litigation (including preferences, and fraudulent conveyances) and potential recoveries.

VI. INSIDERS. The Disclosure Statement should disclose the following information about insiders of the Debtor:

1. If the Debtor is a closely held corporation, identify the shareholders and officers;

2. Any claims against insiders and related entities and their value (including the consideration and legal basis for the waiver of any of these claims);

3. Any claims by insiders against the Debtor and their proposed treatment;

4. 11 U.S.C. § 1129(a)(5) statutory disclosure of the Debtor's postconfirmation directors, officers, and insiders, and their salaries.

VII. FINANCIAL EXHIBITS. The cliche that "a picture is worth a thousand words" also applies to Disclosure Statements. The following financial exhibits provide essential information to creditors voting on the Plan. These exhibits should be referenced and integrated into the appropriate narrative sections of the Disclosure Statement.

1. Summarized Financial Statements. Financial statements arranged in a tabular or spreadsheet format summarizing the Debtor's Chapter 11 postpetition operations (a summary of the Debtor's prepetition financial statements should also be included in those cases where the Plan has been submitted soon after the Chapter 11 filing and little or no postpetition financial track record exists);

2. Projections. Projected postconfirmation financial statements for the duration of the Plan (including an explanation of the methodologies used and assumptions made and, if the projections vary significantly from historical financial data, an explanation for the differences);

3. Payment Schedule. A schedule listing the total dollar amount and number of creditors in each class (be sure to review the Bankruptcy Court's claims docket), the required periodic payments for each class for duration of the Plan, and how the Debtor's projected income or funding will be applied to the periodic payments required by the Plan;

4. Liquidation Analysis. A liquidation analysis which sets forth values assigned to assets and relates their distribution to creditors under a hypothetical Chapter 7. All assets should be included (including potential causes of actions and provision for exemptions if the Debtor is an individual) together with explanations for the assumptions and methodologies applied in determining the discounted values assigned to assets. The analysis should conclude by stating the specific percentage distribution to unsecured creditors upon liquidation.

VIII. MISCELLANEOUS. The Disclosure Statement should provide creditors with a brief discussion of the options available to them under alternate scenarios, such as:

1. The failure to confirm the Plan;

2. The failure to consummate the Plan (a paragraph concerning creditors' remedies after confirmation, similar to the following, should be included:

"After the Plan is confirmed, the Debtor will have the responsibility of complying with all the provisions of the confirmed Plan. Any aggrieved creditor who wishes to enforce its rights under the Plan must file a motion with the Bankruptcy Court for whatever relief is appropriate.");

3. The conversion to Chapter 7 (the liquidation analysis referenced in Section VII. 4. of this article should be discussed).

REMINDERS

Numerous comments and objections to Disclosure Statements filed by the U.S. Trustee revealed several patterns. Some of the most common problems can be easily avoided. First, label any and each successive revision or modification made to the Disclosure Statement as "First Amended," "Second Amended," etc., in order to avoid confusion. Second, attach all referenced exhibits and label them to correspond with the references made to them in the narrative. Third, review the final work product before filing with the Court to ensure that the document has no grammatical or typographical mistakes and no internal inconsistencies. Finally, the Disclosure Statement, Plan of Reorganization, ballot, schedules, and financial statements should contain consistent information (or an explanation for any differences).

APPLICABLE FEDERAL RULES
OF BANKRUPTCY PROCEDURE

Timing. Generally speaking a Disclosure Statement must be filed "with the Plan or within a time fixed by the Court" according to F.R.B.P. 3016(c). Thus, merely filing a Plan alone in order to comply with, for example, a Plan deadline provision in an adequate protection order, may be inadequate under this rule.

Escrow deposit of plan payments. When appropriate, the judges sitting in this district are requiring Debtors to establish and fund an escrow account for Plan payments pursuant to F.R.B.P. 3020(a). This rule states as follows:

> (a)Deposit. In a Chapter 11 case, prior to entry of the order confirming the plan, the Court may order the deposit with the trustee or debtor in possession of the consideration required by the plan to be distributed on confirmation. Any money deposited shall be kept in a special account established for the exclusive purpose of making the distribution.

Accordingly, appropriate language should be included in the Debtor's proposed order approving the Disclosure Statement. Including this representation voluntarily in the Disclosure Statement may also help the Debtor garner some favorable votes by providing creditors with an additional element of assurance that the Plan will be complied with.

CONCLUSION

The U.S. Trustee has been assigned the duty in his discretion to review and comment on Disclosure Statements. See 28 U.S.C. Section 586(a)(3)(B). The U.S. Trustee will also gladly preview a proposed Disclosure Statement drafted by inexperienced counsel before filing. However, Disclosure Statements that give attention to the items discussed in this article will generally not need to be modified significantly.

RECENT BANKRUPTCY DECISIONS

The following are summaries of recent Court decisions that address important issues of bankruptcy law and procedure. These summaries were prepared by Joseph M. Ammar with the assistance of Larry VerMerris.

In re Woolum, Case No. 92-5107 (6th Cir. November 4, 1992). In this case, the Sixth Circuit held that the district court erred in determining that a lender's reasonable reliance on written financial statements, in regard to a §523(a)(2)(B) nondischargeability action, is a mixed question of law and fact subject to de novo review. Instead, whether a creditor's reliance is reasonable is a factual determination to be made in light of the totality of the circumstances. As a factual determination, this finding must be reviewed under the deferential clearly erroneous standard. In addition, a district court reviewing a bankruptcy court's determination of reasonable reliance is not to undertake a subjective evaluation and judgment of a creditor's lending policy and practices.

The debtor's financial statements did not disclose guaranty obligations. The Sixth Circuit concluded that the bankruptcy court's findings that the bank actually relied on the debtor's written financial statements in making the loans and that the reliance was reasonable were not clearly erroneous. The district court's judgment was reversed and the case was remanded to reinstate the bankruptcy court's nondischargeability judgment.

In re Charfoos, Case No. 91-1516 (6th Cir. July 7, 1992). In this decision, the Sixth Circuit upheld the district court's dismissal of an individual Chapter 11 debtor's petition for bad faith. Bad faith was indicated by the debtor's factual misrepresentations and omissions on financial statements and bankruptcy pleadings and the debtor's violation of a pre-petition state court order requiring him to refrain from transferring any property.

In re Ross, Case No. 92-72429 (E.D. Mich. September 14, 1992). This opinion, authored by Judge Gadola, involves the automatic stay's tolling of a redemption period under a land contract forfeiture judgment.

The debtors were land contract vendees. The vendor served a notice of forfeiture on the debtors and obtained a default judgment granting the vendor possession pursuant to forfeiture proceedings. Under Michigan law, a 90-day redemption period begins to run as of the date of the forfeiture judgment. The failure to cure a default by the end of the redemption period entitles a vendor to obtain a writ of restitution and evict a vendee.

The debtors filed a Chapter 13 petition when 89 days were left in their redemption period. After the debtors' nonpayment, the Chapter 13 case was dismissed. The vendor then filed for a writ of restitution. Two days later, the debtors filed their second Chapter 13 petition.

The bankruptcy court granted the vendor's motion for relief from stay, finding that the redemption period expired before the second Chapter 13 case was filed.

The district court reversed the bankruptcy court's decision. The vendor was not entitled to execute the writ of restitution because the automatic stay in the first case tolled the running of the 90-day redemption period at 89 days. When the first case was dismissed, the redemption period again began running. When the debtors filed their second petition, 46 days of the redemption period remained. Because the second petition was still pending, the redemption period was tolled at 46 days.

According to the district court, the automatic stay tolls the running of periods of redemption under land contract forfeiture judgments. Therefore, the lifting of the automatic stay was improper.

In re Mendell, Misc. Proceeding. No. 91-2000 (Bankr. W.D. Mich. September 24, 1992). In this unpublished opinion by Judge Howard, the court held that a nondischargeability judgment of a Wisconsin Bankruptcy Court was properly registered with the Western District of Michigan Bankruptcy Court. However, the plaintiffs' writs of garnishments were quashed, since the plaintiffs could not reach certain real property interests through garnishment under Michigan law.

In re Grand Traverse Development Company Limited Partnership, Case No. ST 92-83818 (Bankr. W.D. Mich. November 6, 1992). In this case, Judge Stevenson denied the secured creditor's motion to shorten the debtors' exclusivity period to file a plan and solicit acceptances under §1121.

The court first held that since the debtors filed their plans within 120 days of the petition date, the motion to shorten the 120-day period was meaningless. In denying the secured creditor's motion to shorten the 180-day period, the court reasoned that there were no allegations of gross mismanagement, the debtors were diligent in moving the case toward confirmation, and the filing of a competing plan would seriously erode the debtors' chance of reaching confirmation, thus effectively diminishing the protection of §1121. By denying the secured creditor's motion, the court also sought to further the policy of encouraging consensual reorganizations.

In re Casa Nova of Lansing, Inc., Case No. SL 91-85736 (Bankr. W.D. Mich. October 27, 1992). This decision by Judge Stevenson involved the sale of a restaurant. The seller/plaintiff sought retransfer of a liquor license, foreclosure of its security in assets of the business and money damages. The buyer/defendant asserted the defenses of breach of contract and fraud, which were also the basis of its counterclaim and third party complaint.

The court held that the buyer/defendant was barred from pursuing its fraud claim under the equitable doctrine of unclean hands. The breach of contract action was also dismissed since the covenant not to compete was part and parcel of the fraudulent contract the parties reached. In addition, the court dismissed the seller/plaintiff's complaint based on the rule of in pari delicto. In essence, the court denied relief because both parties behaved fraudulently in one aspect or another.

In re Adams, Case No. 91-82000 (Bankr. W.D. Mich. November 4, 1992). In this case, Judge Gregg held that a state court judgment debt was nondischargeable as a willful and malicious injury pursuant to §523(a)(6).

The debtor drove his automobile through a red light at a high rate of speed through a busy intersection and collided with the plaintiff's automobile, seriously injuring the plaintiff.

For an injury to be "willful" it must be the result of an intentional or deliberate act. A plaintiff, as a minimum requirement under §523(a)(6), must establish inferred intent. This means that if the court determines that by the nature of his or her act, the debtor knew, or should have known, the resulting harm was substantially certain to occur, the "willful" prong of §523(a)(6) is satisfied. In determining whether intent should be inferred, the debtor's belief should be reviewed by an objective or reasonable person standard considering the totality of the circumstances. According to the court, the debtor's act of speeding and accelerating through a red light at a congested intersection was "willful."

The second prong which must be established is a "malicious" injury. Implied malice for §523(a)(6) purposes is proven when a creditor shows a debtor acted in conscious disregard to the rights of others, without just cause or excuse. Considering the totality of the circumstances, the court held that the debtor acted "maliciously."

In re Witherell Corporation, Case No. 91-11638-R (Bankr. E.D. Mich. October 21, 1992). In this decision, Judge Rhodes held that the perfection of a general partner's security interest in the debtor's interest in a limited partnership is governed by Article 9 of the Uniform

Commercial Code. Since the general partner did not file a financing statement, his security interest was unperfected. The court found that Article 8 was not applicable because the partnership did not comply with the Article 8 registration requirements for uncertificated securities.

Renkiewicz v. ***Allied Products Corporation***, Case No. 134931 (Mich. Ct. App. October 19, 1992). This Michigan Court of Appeals' opinion involves the issue of the liability of a buyer at a §363 sale for product liability claims.

The debtor, a tractor manufacturer, filed a Chapter 11 petition in 1985. Later that year, the buyer purchased substantially all of the debtor's assets free and clear of all liens, claims and encumbrances. Moreover, the acquisition agreement specifically provided that the buyer was not liable for product liability claims. On November 11, 1987, a plan of reorganization was confirmed. On December 15, 1987, plaintiffs' decedents, while driving a tractor designed and manufactured by the debtor, slid off the road and were killed. In 1989, plaintiffs filed a product liability complaint against the debtor and the buyer. The plaintiffs alleged that the buyer was the successor corporation of the debtor. The buyer moved for summary disposition, claiming that no liability could be imposed on it because it acquired the debtor's assets under the Bankruptcy Code, which preempts state successor liability law.

The trial court granted the buyer's motion for summary disposition. The Michigan Court of Appeals reversed the trial court, holding that the Bankruptcy Code does not preempt state successor liability law where plaintiffs possess an unaccrued future claim.

In Michigan, a products liability claim does not accrue until an injury occurs. Plaintiffs' claim arose after confirmation. According to the court, only debts which arise before confirmation may be discharged under §1141(d). Because the plan was confirmed before plaintiffs' claims arose, the claims could not be discharged by the bankruptcy court under §1141(d). As a result, the trial court erred when it held that the bankruptcy court's ruling preempted state successor liability law in situations involving an unaccrued future claim.

Derr v. ***Murphy Motor Freight Lines***, 195 Mich. App. 333 (1992). In this decision, the plaintiff injured his back and received workers' compensation benefits. The plaintiff then refused a job which met his medical restrictions. The Workers' Compensation Appeal Board found plaintiff forfeited his right to benefits from the date of his refusal, but held that plaintiff's right to benefits was reinstated almost two years later when the employer filed for bankruptcy. The favored-work doctrine requires only that an employer keep open an offer for reasonable time. The Michigan Court of Appeals reversed the WCAB's decision, finding that even though the company's bankruptcy meant the offer was withdrawn, plaintiff was not once again entitled to compensation benefits.

STEERING COMMITTEE MEETING MINUTES

A meeting of the Steering Committee of the Bankruptcy Section of the Federal Bar Association for the Western District of Michigan was held on December 2, 1992 at the Peninsular Club. Present: Brett Rodgers, Tim Curtin, Bob Wright, Janet Thomas, Thomas Sarb, Steve Rayman, Peter Teholiz, Jim Engbers, Bob Mollhagen, Mark Van Allsburg, Marcia Meoli, Dan Brondyk (for Patrick Mears), Tom Schouten, Mike Purner.

1. Election of Steering Committee Members and Officers. Colleen Olson having submitted her resignation due to her inability to attend meetings in Grand Rapids on a regular basis, a motion was made to accept her resignation with regret. The motion was seconded and passed.

Tim Curtin moved that the membership of the Steering Committee be expanded from 13 to 15 persons by adding additional terms expiring August, 1994 and August, 1995, one of which would be occupied by the editor of the Bankruptcy Law Newsletter. Motion was seconded and passed.

A motion was made to elect Denise Twinney to a term on the Steering Committee ending in August, 1994. The motion was seconded and passed.

Pat Mears and Bob Wright having volunteered to serve as chairperson and chairperson-elect, respectively, for two year terms, a motion was made that Pat Mears be elected as chairperson of the Steering Committee for a two year term ending August, 1994, and Bob Wright be elected chairperson-elect to serve in that position through August, 1994, and then as chairman for a two-year term ending August, 1996. The motion was seconded and passed.

A motion was made to elect Tim Hillegonds, Tom Sarb, Peter Teholiz, and Steve Rayman to three year terms

on the Steering Committee ending August, 1995. The motion was seconded and passed.

2. Newsletter Editor and Recent Bankruptcy Decisions Edition. Tom Sarb reported that he had already received several calls from volunteers interested in assuming the preparation of the Recent Bankruptcy Decisions column of the Newsletter. Tom Sarb indicated that he would be willing to continue as editor as the Bankruptcy Law Newsletter through August, 1993, to complete a two-year term. Bob Mollhagen having volunteered, a motion was made that Bob Mollhagen succeed Tom Sarb as editor of the Bankruptcy Law Newsletter for a two year term beginning September, 1993. The motion was seconded and passed.

3. Seminar Location. After discussion of the various alternatives and times for the 1993 Western District of Michigan Federal Bar Association Bankruptcy Seminar, a motion was made that the seminar be held at the Lakeview Hotel on Mackinac Island. The motion was seconded and passed. Brett Rodgers to confirm date.

4. Seminar Speakers. Various names were suggested as possible speakers for the 1993 seminar. Any person having suggestions for keynote speakers for the seminar should send those suggestions to Steve Rayman, Educational Committee Chairperson. Any persons having suggestions as to topics should make those suggestions to the Educational Committee consisting of Steve Rayman, Tom Schouten, and Dan Casamatta.

5. Possible Bankruptcy Mediation Rule. Tom Schouten reported that he had received a communication from Mark Van Allsburg on behalf of the bankruptcy judges indicating that the court would be willing to consider a bankruptcy mediation rule. However, the judges recommended that the Local Rules Committee study the issue carefully as to how alternative dispute resolution is being handled in other bankruptcy districts. Tom Schouten indicated that he has obtained additional materials from the administrative office on alternative dispute resolution programs and has had contact with Judge Thomas Baynes, Jr., bankruptcy judge for the Middle District of Florida, regarding that District's bankruptcy mediation rule. Tom Schouten, Peter Teholiz, and Bob Wright will review the existing materials, investigate the matter further, and report back at the next Steering Committee meeting. Any comments should be submitted to Tom Schouten.

6. Portrait of Judge Nims. A motion was made to appoint Bob Sawdey to arrange that a portrait of Judge Nims be obtained and hung with the portraits of the other former bankruptcy judges. The motion was seconded and passed.

There being no further business to come before the Committee, the meeting was adjourned. The next meeting of the Steering Committee will take place on Friday, January 15, at 12:00 at the Peninsular Club.

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United States Bankruptcy Court for the Western District of Michigan (Lower Peninsula) during the period from January 1, 1992 through October 31, 1992. These filings are compared to those made during the same period one year ago and two years ago.

	1/1/92-10/31/92	1/1/91-10/31/91	1/1/90-10/31/90
Chapter 7	4,546	4,257	3,324
Chapter 11	108	134	119
Chapter 12	23	21	15
Chapter 13	1,338	1,446	1,419
	6,015	5,858	4,877

EDITOR'S NOTEBOOK

The decision of the Michigan Court of Appeals in the case of Renkiewicz v. Allied Products Corporation, described in this month's Recent Bankruptcy Decisions column, imposing successor personal injury liability upon a purchaser of assets from a bankruptcy court sale, is a very troubling decision for those who represent purchasers from bankruptcy court sales, debtors, trustees, creditors, or virtually anyone who participates in the bankruptcy process. The Court of Appeals in Renkiewicz appears to have confused the concept of dischargeability of claims (indeed, as to this debtor, the plaintiff's claim was not discharged) and the concept of bankruptcy sales being free and clear of claims, with the claims being channeled to the proceeds of sale. In any event, in failing to follow the traditional holding that such sales are free and clear of claims, see e.g. In re White Motor Credit Corp., 75 B.R. 944 (Bankr. N.D. Ohio 1987), the Renkiewicz case has imposed a significant chill on the bankruptcy sale process, and may substantially impair the goal of using bankruptcy court sales to maximize assets for the benefit of creditors.

Thomas P. Sarb

1993 SEMINAR DATE

Mark your calendars for the 1993 Western District of Michigan Federal Bar Association Bankruptcy Seminar. It will be held July 29-31, 1992, at the Lakeview Hotel on Mackinac Island. Details in future issues of this Newsletter.

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