

Principles of Business Credit

Eighth Edition

National Education Department

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PART VI

BANKRUPTCY

Chapter 17: Bankruptcy Code Proceedings

Chapter 18: Bankruptcy Alternatives

17

Bankruptcy Code Proceedings



DISCIPLINARY CORE IDEAS

After reading this chapter, the reader should understand:

- ✓ The automatic stay provisions of the Bankruptcy Code.
- ✓ Chapters 7, 11, 12 and 13 of the Bankruptcy Code.
- ✓ How to establish a response to bankruptcy filings.
- ✓ How to pursue claims.
- ✓ How the Office of the U.S. Trustee works.
- ✓ The basic recovery procedure.

CHAPTER OUTLINE

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Questions for Discussion



THINK ABOUT THIS

- : Q. What are the most important factors to ensure the business receives payment when a customer files for bankruptcy?
- : Q. What steps can a creditor take to mitigate risk exposure if the possibility of a bankruptcy exists?
- : Q. After learning a customer has filed for bankruptcy, what steps should a creditor take?

Bankruptcy Code History and Summary

- Title 11 of the U.S. Code
- The **Bankruptcy Act of 1898**
- Adopted in 1978
- **Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)**
- **Chapter 1, 3, 5** contain *administrative provisions that apply in all cases under the Bankruptcy Code.*
- **Chapter 7, 9, 11, 12, 13, 15** are the *operative chapters for filing different types of bankruptcies*

Federal Rules of Bankruptcy Procedure

- *Congress has empowered the Supreme Court to adopt rules of procedures for bankruptcy cases, which are called the **Federal Rules of Bankruptcy Procedure**.*



Comprehension Check

Provide a brief definition of the following chapters of the Bankruptcy Code: **7, 9, 11, 12, 13 and 15.**

The Automatic Stay

The Automatic Stay halts actions by creditors to collect debts, including to:

- Begin or continue judicial proceedings
- Obtain possession of the debtor's property
- Create, perfect or enforce a lien
- Set off indebtedness owed

The purpose of the Automatic Stay is to ensure a fair distribution of the debtor's nonexempt, unencumbered assets among creditors.

- *What Happens When the Owner Goes Bankrupt?*
- *Perfecting the Lien*
- *The Automatic Stay*
- *Enforcement*

Chapter 7 Liquidation

Most common type of bankruptcy filing in U.S., *is a straight bankruptcy or liquidation.*

- Means test
- Interim trustee
- Section 341 meeting
- Trustee's Compensation
- Filing a Proof of Claim
- Distribution of Assets
- Discharge Litigation



Comprehension Check

What is the purpose of an automatic stay in bankruptcy?

Distribution of Assets

1. **Secured Creditors**
2. **Administrative Expenses**
3. **Involuntary Case Claims**
4. **Wages and Compensation Claims**
5. **Employee Benefit Plans**
6. **Grain Producers or Fisherman Claims**
7. **Customer Deposits**
8. **Taxes**
9. **Unsecured Claims of a Federal Depository Institutions Regulatory Agency**
10. **Claims Arising from the Unlawful Operation of a Motor Vehicle or Vessel**
11. **Unsecured Creditors**
12. **Preferred Stockholders**
13. **Common Stockholders**



Comprehension Check

What are the basic duties of a trustee?

Chapter 11 Reorganization

One of the most important provisions of the Bankruptcy Code, was designed to be a *single, unified way of dealing with a reorganization of most businesses.*

- Key Players
- Types of Petition and Jurisdiction
- Role of the Trustee
- Debtor in Possession
- Proof of Claim
- Notifications



Comprehension Check

In a Chapter 7, **trustees** must satisfy claims in a particular order. List the priority of claims in order.

Chapter 11 Continued...

- **Creditors' Committee**
- **Assumption or Rejection of Executory Contracts**
- **Plan of Reorganization**
- **Secured Creditors**
- **Unsecured Creditors**
- **Interest Classification and Treatment**
- **Provision for Execution of Plan**

Chapter 11 Continued...

- Voting Process
- Confirmation Process
- The Absolute Priority Rule
- Post-confirmation Problems
- Prepackaged Chapter 11 (Prepack)
- Prearranged Chapter 11



Comprehension Check

What is the purpose of Chapter 11?



Comprehension Check

Who are the key players in a Chapter 11 proceeding?

Chapter 12 Adjustments of Debts of a Family Farmer or Fisherman with Regular Annual Income

Bankruptcy Code in 1986 *providing special provisions relating to the reorganization of family farmers and family fishermen*. It has some of the provisions found in Chapters 11 and 13 of the Bankruptcy Code.

- **Confirmation**

- Plans must satisfy two conditions:

1. Creditors are to receive what they would receive under liquidation (the liquidation test).
2. All the debtor's disposable income for three to five years must be paid to creditors (the best efforts test).

- **Trade Creditors' Primary Concerns**



Comprehension Check

What is the role of a **creditors' committee** in a Chapter 11 proceeding?

Chapter 13 Adjustments of Debts of an Individual with Regular Income

affords an individual with regular income an opportunity to reorganize their debts.

There are three criteria for filing under **Chapter 13**:

1. The debtor must be an individual.
2. The individual must have regular income.
3. The debt's limit is \$394,725 in unsecured debt and \$1,184,200 in secured debt. The thresholds are periodically adjusted for inflation.

- **Summary of a Typical Case**
- **The Chapter 20 and Chapter 22 Maneuvers**



Comprehension Check

How long does a debtor have to assume or reject **executory contracts**, with court approval, under a Chapter 11 proceeding?

Establishing a Systematic Response to Bankruptcy Filings

- Filing a Proof of Claim
- The Official Proof of Claim Form



Comprehension Check

Define the term **claim**, under the Bankruptcy Code.

.....

How is a **small business** defined under Chapter 11 of the Bankruptcy Code?

Bankruptcy: Things to Consider

- **Objections to Proofs of Claims**
- **Reclamation**
 - Catch -22
 - State Law Reclamation Rights
 - Reclamation Rights under Bankruptcy Code Section 546(c)
 - Circuit City Case
- **20-Day Administrative Claim**
- **Discharge and Dischargeability**
 - Reasons for Denial of Discharge in Chapter 7
- **Pursuing Claims for False Financial Statements and Fraud**
 - Trustee's Strong Arm and Avoiding Powers

Basic Recovery Procedure

- **Settlement Considerations**
- **Trustee's Strong Arm Powers**
 - Hypothetical Judicial Lien Holder
 - Unsecured Creditor
 - Bona Fide Purchaser for Value of any Property Owned by Debtor as of Date of Petition
- **Legal Audit**



Comprehension Check

How are claims classified
under the Bankruptcy Code?

Preferences

To prove a preference, the trustee or DIP must prove a transfer of the debtor's assets was made:

- To or for the benefit of a creditor
- For or on account of an antecedent debt
- While the debtor was insolvent
- Within 90 days of the petition for relief or one year if transfer was to an insider
- The transfer gave the creditor more than they would have received in a Chapter 7 liquidation.

Exceptions to the Preference Rules

- A transfer to a creditor that is intended to be and is contemporaneous with the extension of credit or the delivery of goods by the creditor.
- Subsequent new value is given to the debtor after receipt of payment.
- Payment in the ordinary course of business or financial affairs of the debtor and the creditor; or made according to ordinary business terms.
- Preference actions for recovery of less than \$6,425 cannot be pursued.
- Preference actions to recover less than \$12,475 can be commenced only in the district court for the district where the trade creditor is located.



Comprehension Check

What information is contained in a **plan of reorganization**?



Comprehension Check

In order for a **plan of reorganization** to be accepted, what is necessary?

Bankruptcy Considerations

- Fraudulent Transfers
- Involuntary Bankruptcy
- Strategy
- Beginner's Guide to Bankruptcy



Comprehension Check

What two conditions must a plan satisfy under **Chapter 12**?



Comprehension Check

List the three criteria for filings under **Chapter 13**.

Summary

- The Bankruptcy Code is federal law that provides an organized procedure under the supervision of a federal court for dealing with insolvent debtors. This became law in 1979. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) is the most recent update of bankruptcy law that establishes rules governing bankruptcies for individuals, corporations, small businesses and farms, as well as multination debtors.
- Chapters 7, 9, 11, 12, 13 and 15 are chapters of the Bankruptcy Code that outline the filing of different types of bankruptcies. One of the most important things to know about the Bankruptcy Code is the adherence to different filing deadlines because noncompliance can affect a creditor's rights under the law. If there is any conflict between the provisions of Bankruptcy Code itself and the various applicable rules, the Bankruptcy Code always takes precedence.
- An **automatic stay** is immediately instituted when a bankruptcy petition is filed. Its purpose is to ensure the fair distribution of nonexempt, unencumbered assets among creditors. The resulting actions that are halted include:
 - Beginning or continuing judicial proceedings against the debtor
 - Obtaining possession of the debtor's property
 - Creating, perfecting or enforcing a lien against a debtor's property
 - Setting off indebtedness owed to the debtor that arose prior to the bankruptcy proceeding

Summary Continued...

- **Chapter 7** bankruptcy is the most common and involves liquidation. The debtor must satisfy a means test. During a Chapter 7 bankruptcy a trustee is appointed. The trustee has several legal obligations that include, but are not limited to, the following:
 - Sell any assets of the estate at the benefit of the creditor
 - Investigate the financial affairs of the debtor
- If a creditor wishes to participate in the distribution of the estates assets, the creditor must file a proof of claim. It indicates the amount of debt owed by the debtor.
- **Trustees** must satisfy all claims in a particular order. The order of priority includes:
 - Secured creditors
 - Administrative expenses
 - Involuntary expenses
 - Wages and compensation claims
 - Employee benefits plans
 - Grain producers or fisherman claims
 - Customer deposits
 - Taxes
 - Unsecured claims of a federal depository institutions regulator agency
 - Claims arising from the unlawful operation of a motor vehicle or vessel
 - Unsecured creditors
 - Preferred stockholders
 - Common stockholders



Comprehension Check

Why is it important to establish a systematic response system for bankruptcy cases?



Comprehension Check

Under what chapters of the Bankruptcy Code must a proof of claim be filed?

Summary Continued...

- A creditor that has any concern about how the case is being handled by the trustee has two options: retain counsel to object to the trustee's final report, or contact the U.S. Trustee for the district in which the case is pending.
- A petition for bankruptcy must be filed in the location where the principle business exists, or where the principle place that assets of the debtor have been held for 180 days or longer. Most petitions are initiated by the debtor, but may be filed by creditors under Chapter 7 or Chapter 11.
- The Bankruptcy Code gives all creditors the right to be notified about any actions that affect the operation of the business and the assets of the bankruptcy estate. Any post-petition unsecured credit obtained by the debtor outside the ordinary business operations must get approval from the courts.
- The U.S. Trustee forms a creditors committee. The financial stake of the committee members, as well as expertise in the industry, give them tremendous influence in the case. They are often the deciding factor for the plan to be confirmed. The committee must also provide access to information by all creditors. Many create websites to fulfill this rule, and the sites provide information like monthly committee reports, or access to the claims docket.
- **Chapter 11** allows a debtor to assume or reject an unexpired executory contract or lease if the court approves. The debtor has 120 days after the bankruptcy to assume or reject unexpired leases of nonresidential real property.

Summary Continued...

- Many Chapter 11 bankruptcies fail to reorganize and end up being converted to Chapter 7 bankruptcies or dismissed.
- A **plan of reorganization** incorporates a method of classifying claims, secured and unsecured creditors being put into separate classes. Creditors should examine the plans in order to see how classification affects their interests. Creditors may file objections to the classifications before the confirmation hearing, or earlier. **Plans** may include:
 - **Extension plans**
 - **Compromise plans**
 - **Partial payments**
 - **Debt for equity swap**
- In order for reorganization plans to be accepted, a majority from each class must accept the plan. The court is likely to confirm a plan if all classes of creditors and interest holders have accepted the plan with necessary majorities. The court, through a **cramdown**, also has the right to accept the plan even if one or more classes doesn't accept the plan.
- Chapter 11 bankruptcies may also come **prepackaged** (prepack) or **prearranged**. Prepacks make an agreement with all creditors, while a prearranged bankruptcy only makes an agreement with some creditors. There are several advantages to a prepack or prearranged Chapter 11 bankruptcy, such as shortening the timeframe of the bankruptcy process, lowering cost and fees, and limiting uncertainty. However, a prearranged Chapter 11 bankruptcy doesn't ensure that trade creditors receive full or any payment.
- **Chapter 12** eliminates the absolute priority rule, and the plans must satisfy two conditions:
 - Creditors are to receive what they would receive under liquidation (**liquidation test**)
 - All the debtor's disposable income for three to five years must be paid to creditors (**best efforts test**)

Summary Continued...

- The three criteria for filing a **Chapter 13** Bankruptcy include:
 - The debtor must be an individual
 - The debtor must have a regular income
 - The debt's limit is \$494,725 in unsecured debt and \$1,184,200 in secured debt. Thresholds are subject to periodic adjustment for inflation
- An efficient internal system for handling bankruptcy should be created. This includes the routing of bank notices so the information goes to the correct individual. Generally a proof of claim is required for Chapters 7, 12 and 13. In all cases, official proof of claim **Form 410** should be used. Objections to claims can be filed, but should be limited due to the administration costs associated with an objections, which inevitably is removed from the total amount available to unsecured debtors.
- The law provides for the protection of creditors who deliver goods to an insolvent debtor through the concept of reclamation. Goods subject to reclamation include those received up to 45 days prior to the bankruptcy filing. Creditors have up to 20 days after the filing to send a demand for reclamation.
- The goal of any bankruptcy proceeding is the discharge of some or all debtor's debts and obligations. Some reasons for denial of discharge under Chapter 7 cases include:
 - Corporations are not normally discharged
 - Concealing assets
 - Failure to keep records

Summary Continued...

- **Certain debts are allowed to be discharged. Some of these debts include:**
 - Student loans
 - Credit received using false financial statements
 - DUI liabilities
- **Before a preferential payment can be recovered the trustee or debtor must prove that a transfer of the debtor's assets was made:**
 - To or for the benefit of the creditor
 - For or on account of an antecedent debt
 - While the debtor was insolvent
 - Within 90 days of the petition of relief, or within a year if it was to an insider
 - The creditor received more than it would have under Chapter 7 liquidation
- **Often, involuntary bankruptcy is the only way to force the debtor to provide full financial disclosure.**

Summary Continued...

- Creditors should accept all payments offered by the debtor in financial difficulty.
- The following checklist can assist those outside the legal profession make an initial evaluation of a bankruptcy:
 - Routing system
 - Bankruptcy checklist
 - Documentation/Data
 - Goods in transit
 - Deadline for filing claims
 - Deadlines for objections to discharge and complaints to determine dischargeability
 - Motions for trustee or examiner in Chapter 11
 - Consult counsel to file a motion



Comprehension Check

Before a **preferential payment** to an **unsecured creditor** can be recovered, what must the **trustee** prove?

.....
What are the exceptions to the preference rules?



Comprehension Check

What is a **fraudulent transfer**?

18

Bankruptcy Alternatives



DISCIPLINARY CORE IDEAS

After reading this chapter, the reader should understand:

- ✓ How to identify a financially distressed debtor.
- ✓ What is involved in a voluntary settlement of claims.
- ✓ The different kinds of settlement plans.
- ✓ The different methods of resolution.
- ✓ The two types of assignments for the benefit of creditors.
- ✓ How to evaluate settlement offers.

CHAPTER OUTLINE

1. Identifying the Distressed Debtor 18-2
2. Voluntary Settlements 18-3
3. Methods of Resolution 18-6
4. Assignment for the Benefit of Creditors 18-10
5. Evaluating Settlement Offers 18-15

Questions for Discussion



THINK ABOUT THIS

- Q. How can alternatives to bankruptcy be advantageous to both the debtor and its creditors?
- Q. How can the time of the settlement payment affect the amount the creditor receives?

Identifying the Distressed Debtor

- **Warning signs**
 - The debtor has stopped taking advantage of available discounts.
 - There is a general slowdown in payments to vendors.
 - Lawsuits are being filed against the debtor.
 - Tax or vendor liens are being filed against the debtor.
 - The debtor is constantly shifting from one supplier to another.
 - The debtor is in default with its lending institutions.
 - The financial condition of the company is deteriorating.
- **Public information and records**
- **Insolvency and Non-Liquidity**

Figure 18-1

Handling Distressed Debtors

Exhibit 1

Reorganize the Financial Affairs

- Formally through bankruptcy proceedings
 - Chapter 9, 11, 12 or 13
- Through non-bankruptcy proceedings
 - Voluntary Settlement such as:
 - Composition Agreement
 - Extension Agreement
 - Combination Settlement
 - Involuntary Proceeding
 - Receivership

Exhibit 2

Liquidate the Business

- Formally through bankruptcy proceedings
 - Chapter 7 or 11
- Through non-bankruptcy proceedings
 - Voluntary Settlement such as:
 - Assignment for the Benefit of Creditors
 - Liquidation Agreement
 - Involuntary Proceeding
 - Receivership

Voluntary Settlements

- *is a contract between the debtor and its creditors that settles their claims for the most the debtor can pay and the most the creditors can realize.*
- Advantages and Complications
- Initiating the Voluntary Settlement
- Secured Claims
- Priority Claims



Comprehension Check

List the warning signs of financial distress.

Voluntary Settlements Continued...

- Settlement Plan
- Importance of Unity in Voluntary Settlements
- Creditors' Committee
 - Objects of Investigation
 - Causes of Financial Distress
 - Questionable Actions by Debtor
 - Reaction of Creditors' Committee
 - Positive Findings by the Creditors' Committee



Comprehension Check

Explain the difference between **insolvency** and **non-liquidity**.



Comprehension Check

What may a **secured claim** consist of?

Methods of Resolution

- **Alternative Dispute Resolution**
 - **Mediation**
 - **Arbitration**
- **Extension Agreement**
 - **Establishing Controls**
 - **Transfer of Stock**
 - **Financial Controls**
 - **Security**
 - **New Trade Creditors**
- **Composition Agreement**
 - **The Settlement Percentage**
 - **Creditors with Small Claims**
- **Combination Settlement**
- **Administration Costs**
- **Execution of the Settlement**

VARIATION ON A THEME: SMALL CLAIMS IS A BREEZE

My first position as a credit manager was at a local seafood company in St. Louis. It was decided in the interest of saving money, that I would do all of my own small claims cases. After a few days of training, I began haunting the courthouses in St. Louis City and St. Louis County and observed several cases over the next few weeks. I watched and took a lot of notes. I tried to figure out what the judges did and didn't like. I began to get a feel of how the whole process worked.

There was a limousine company being sued by its customers because the driver had spun the tires on their lawn and damaged the landscape. The driver claimed that the passengers were rude and abusive, did damage to the limousine and told him to drive on their lawn in the first place since there was no place to turn around. The judge ended up splitting the fee between them, so no one really prevailed.

There was another case of payment due on the sale of a cockatoo. The judge asked if any payment had been received on the \$1,500 balance due.

"Yes your honor," was the plaintiff's answer. "Five hundred dollars and an iguana."

"Excuse me, what's an iguana?"

"It's a big green lizard, your honor"

My first suit was against a restaurant on South Broadway. They owed us almost the limit of what you were allowed to sue for in that particular court. I filed all my papers and got a court date. I prepared spreadsheets and copies of delivery receipts, invoices and call records. I was a wreck. I paced. I practiced in the mirror. I fretted and had a slight melt down. "You can do this," was my mantra.

The court date finally arrived. I took great care in getting ready that morning. I took out my brand new navy blue suit, navy blue pumps and crisp white blouse. I even left my skirt hanging on the hook on the back of the bedroom door until the last minute so I wouldn't muss or wrinkle it. I did my hair and makeup and made a quick final inspection in the bureau mirror. I looked professional. I was ready.

I arrived at the court house just over two hours early. I had a briefcase full of every document ever created for any transaction having to do with that account. I had spent hours preparing. As I walked the three or so blocks from my car to the courthouse, I was thinking that it was pretty brisk out for a St. Louis spring morning and wished I had worn a coat. Wow, it was downright breezy. As I climbed the steps of the old courthouse, I glanced down to check my skirt for wrinkles and, to my horror, discovered that I had forgotten to put it on. There I was on the courthouse steps, briefcase in hand, in my brand new blue blazer, blue pumps, crisp white blouse—and my slip.

I raced back to my car and broke every speed record in the state of Missouri driving back to my house. I grabbed my skirt off the back of the door, threw it on, raced back to the courthouse and, though breathless, still arrived in time to have my case heard. The defendant arrived late, with little scraps of crumpled paper he called records, which he pulled in fistfuls from his pockets and placed on the table. We were awarded the judgment.

A few months later, after numerous attempts to collect the debt, I paid a visit to the restaurant during a very busy lunch hour, fully clothed I might add. I was accompanied by an extremely large and extremely patient deputy sheriff, who assisted me in enforcing my court order allowing me to seize the contents of the cash drawer. When the proprietor protested loudly, my companion gently took my arm and led me around behind him as if to shield me. He reached to his side, patted his gun and said, "Son, don't cause me to draw my weapon."

We collected what we were owed in full and went on our way. I still believe to this day that it will never be safe for me or anyone in my family to dine there or at any of the proprietor's other restaurants.

I discovered then that I loved working in credit. I loved everything about it. These days, though, when I walk out of my house and have the feeling that I'm forgetting something, I check for keys, purse and wallet. Most importantly, I check my attire in a full-length mirror instead of the one on my waist-high bureau.

Patti Guard-Younce

Assignment for the Benefit of Creditors

- **Statutory Assignment for the Benefit of Creditors**

- **Assignor and Assignee**
- **Effect of the Assignment**
- **Costs of an ABC**
 - Administrative Rent
 - Fees of Assignee and other professionals
- **Steps of an Assignment**
- **Priority Claims**
- **Avoidance Actions**

Actions to Take When Notified of an ABC

1. Is the assignee qualified?
2. Preferences
3. Fraudulent Transfers
4. Reclamation
5. Is a sale to insiders being proposed
6. Executory leases or contracts



Comprehension Check

What may a **priority claim** consist of?

Common Law Assignment and Receivership Proceedings

- Common Law Assignment
 - Sale of Assets
 - Distribution
 - Acceptance
 - Discharge from Obligations
- Receivership Proceedings



Comprehension Check

Why is unity important in voluntary settlements?



Comprehension Check

Explain the important requirements of a creditors' committee.

.....
What items should be examined by the creditors' committee?

Evaluating Settlement Offers

- One-Time Partial Payment
- Present Value of Serial Payments
- Settlements that Benefit Debtors
- Impact of the Cost of Capital



Comprehension Check

List the causes of financial distress.



Comprehension Check

Define **mediation**.



Comprehension Check

Define **arbitration**.

Summary

- **There are many ways of handling insolvency or financially stressed debtors. Generally, one way is to keep the debtor in business and restore it to profitability, and the other is to put the debtor out of business, sell the assets and distribute the proceeds among creditors.**
- **There are many warnings signs that a business is financially distressed. A few include:**
 - **The debtor has stop taking advantage of available discounts**
 - **Tax or vendors liens are being filed against the debtor**
 - **Lawsuits are being filed against the debtor**
- **When a debtors liabilities exceed its debts it is deemed insolvent, and may not be liquid if the business cannot pay debts when they come due. It is imperative that credit professionals distinguish between a business that can be rehabilitated and one that should be liquidated.**
- **Voluntary settlements are simple and may be the best choice if the creditor is willing to take the temporary loss and if the debtor may emerge stable and continue as a customer.**
- **Voluntary claims are generally not advised unless secured claims and priority claims have already been taken care of by the debtor.**

Summary Continued

- **Voluntary claims** usually take one of three forms:
 - **Extensions**
 - **Pro rata cash settlements**
 - **Combination settlements**
- The success of any credit dispute will be the full cooperation of all creditors and the debtor. If there is any preferential treatment, any creditor can rescind the settlement under the basis of fraud.
- During the first meeting of the creditors, a committee should be formed. It should select a chairman, secretary and counsel. The creditors should also ask an accountant be retained to make an independent examination of the debtor's books and records at the cost of the debtor. In these meetings, the creditor should obtain up-to-date objects of investigation, such as inventory and several years of tax returns. With this information, the cause of financial distress may be assessed.



Comprehension Check

What is an extension agreement?

Summary Continued...

- The debtor that remains outside of the formal bankruptcy statistically has a better chance of survival, which ultimately improves the chances that creditors get repaid. Questionable actions can include, but are not limited to, the following:
 - Sudden increases in purchases without corresponding increase in sales
 - Missing financial records
 - Excessively large salaries or expense accounts
- **Extension agreements** can be made, but are only advised if there is a good probability that operations will continue in the future. Creditors can institute controls to ensure the repayment of loans. Controls may include:
 - Transfer of stock
 - Financial controls: security and new trade creditors
- Each method of resolution includes payments of administration costs incurred by the creditors. **Methods of resolution** include:
 - **Alternative Dispute Resolution (ADR)**
 - **Composition agreement**
 - **Combination settlement**



Comprehension Check

What is a **combination settlement**?



Comprehension Check

Describe the process of **assignment for the benefit of creditors**.

Summary Continued...

- **Mediation** and **arbitration** are both methods of resolution. Mediation is non-binding, while an arbitrator acts in lieu of a judge. There are advantages to arbitration. One being, the arbiter may have special knowledge of the industry.
- The difference between a **composition agreement** and a **combination settlement** is that a combination settlement contains, not only a pro rata cash payment, but an extension of time.
- The two types of **assignments** are:
 - **Statutory assignment for the benefit of creditors (ABC)**
 - **Common law assignment**
- **ABCs** are state law, rather than federal law, and ABCs may be advantageous when liquidating assets by avoiding the unpredictability of a Chapter 7 or Chapter 11 bankruptcy proceeding. The biggest advantage may be the cost savings to the estate. Payment must be provided for the following:
 - Administrative rent
 - Fees of assignee and other professionals
- In a common law assignment, the assignee distributes the proceeds of the sale on a pro rata basis among the creditors. However, in a common law assignment, the debtor does not receive a discharge from obligations. Therefore, if the sale of assets is 35 percent of the claim, the debtor still owes the other 65 percent.
- When evaluating settlement offers, a creditor should pay attention to the time value of funds involved. A 100 percent settlement over two years or longer is usually deemed full recovery of a claim. Stretched out repayment schedules cause large losses in the present value for the creditor, even if the payments are made on time. These losses are directly related to the cost of capital at the time.



Comprehension Check

What are the different ways to evaluate settlement offers?

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