BANKRUPTCY 101 FOR EQUIPMENT LEASING PROFESSIONALS

AARON L. HAMMER, ESQ.

CYNTHIA A. BERGMANN, ESQ.

FREEBORN & PETERS LLP

© 2009

TABLE OF CONTENTS

Page

I. BASICS OF U.S. CHAPTER 11 1

A. INTRODUCTION 1

1. Goal of Chapter 11 Process 1

2. Role of Bankruptcy Court 1

B. STRUCTURE OF THE U.S. BANKRUPTCY CODE 1

C. ELIGIBILITY FOR REORGANIZATION 2

1. "Persons" Eligible 2

D. COMMENCING A CHAPTER 11 CASE 2

1. Voluntary Case 2

E. VENUE 2

1. Choice of Venue 2

2. Related Proceedings 3

F. DEBTOR IN POSSESSION 3

1. DIP as Pre-Existing Entity 3

G. THE AUTOMATIC STAY 3

1. Automatic Stay Arises Upon Filing 3

2. Violations of Automatic Stay 3

H. CREDITORS' COMMITTEE AND OTHER COMMITTEES 5

1. The Appointment of Committees 5

2. Secured vs. Unsecured Creditors' Committees 5

3. Conflict Between Committees 5

4. Participation on Committee 5

5. Functions and Powers of Committees 6

I. CONTINUED OPERATION OF THE BUSINESS 6

1. Executory Contracts 6

2. Use, Sale, or Lease of Property 7

3. Obtaining Credit and Working Capital 7

J. MEETING OF CREDITORS 8

1. 341 Meeting 8

2. Meeting to Form Committee 8

TABLE OF CONTENTS
(continued)

Page

K. CHAPTER 11 TRUSTEE 8
  1. Appointment 8
  2. Duties and Functions 8
L. EXAMINER 8
  1. Appointment 8
  2. Duties and Functions 9
M. CONVERSION OR DISMISSAL OF THE CASE 9
  1. General Rule 9
  2. Conversion to Chapter 7 as of Right by Debtor 9
  3. Conversion to Chapter 7 by Party In Interest 9
N. CLAIMS AND INTERESTS 9
  1. Claims 9
  2. Interests 10
O. REORGANIZATION PLAN: FORMULATION 10
  1. Right to File Plan 10
  2. Provisions that Must Be in the Plan 10
  3. Optional Plan Provisions 11
P. THE DISCLOSURE STATEMENT 12
  1. Written Disclosure Statement 12
  2. Adequate Information 12
  3. Requirement of Court Approval 12
  4. Hearing on Disclosure Statement 12
Q. ACCEPTANCE OF THE PLAN 12
  1. Solicitation of Acceptances 12
  2. Numerical Requirements for Acceptance by Claims 12
  3. Votes In Good Faith 13
  4. Numerical Requirements for Acceptance by Interests 13
R. MODIFICATION OF THE PLAN 13
  1. Modification Prior to Confirmation 13

TABLE OF CONTENTS
(continued)

Page

2. Modification After Confirmation but Prior to Substantial Consummation 13
3. Substantial Consummation of Plan 13

S. CONFIRMATION OF THE PLAN 13
1. The Confirmation Hearing 13
2. Requirements for Confirmation: Consensual Plan 13
3. Requirements for Confirmation: Non-Consensual Plan 14
4. The Fair and Equitable Standard in Cramdown Cases 14
5. The Effect of Confirmation 15

T. DISCHARGE OF THE DEBTOR 15
1. Reflected in the Confirmation Order 15
2. Liquidation Plan Excluded 15

U. IMPLEMENTATION OF THE CONFIRMED PLAN 15

V. PREPACKAGED Chapter 11 Reorganization cases 15
1. Introduction 16
2. Prepackaged vs. Traditional Chapter 11 Cases 16
3. Prepackaging vs. Out-of-Court Restructurings 16
4. Variations on Prepackaged Solutions 16
5. Risks in a Prepackaged Chapter 11 Case 17

II. LEASING SPECIFIC BANKRUPTCY ISSUES 18

A. ASSUMPTION/REJECTION AND CURE DISPUTES 18
1. Equipment Leases are “executory contracts” 18
2. Prerequisites to assumption: debtor must cure 18
3. Debtor must surrender leased equipment upon rejection 18
4. Timing of assumption/rejection decision 18
5. Cure disputes 19

B. LEASE RESTRUCTURING DURING CHAPTER 11 19
1. Leases can be restructured just like loans 19
2. Implementing a lease restructuring 19

TABLE OF CONTENTS
(continued)

Page

C. SECTION 1110 OF THE BANKRUPTCY CODE 20
1. Limitation on automatic stay 20
2. "Surrender and return" 20
3. Section 1110(b) Stipulations 20
4. Eligibility for section 1110 protection 20
D. RECHARACTERIZATION: TRUE LEASE VS. DISGUISED SECURED FINANCING 21
1. Significance of distinction 21
2. State law governs 21
3. Fact specific analysis required 21
4. Parties' intent begins analysis 22
5. Economic substance of transaction key 22
E. EQUITY SQUEEZE RIGHTS 23
1. Critical issue in bankruptcy 23
2. Foreclosure may still be a risk 24

BANKRUPTCY 101 FOR EQUIPMENT LEASING PROFESSIONALS

BY

AARON L. HAMMER, ESQ.
CYNTHIA A. BERGMANN, ESQ.
FREEBORN & PETERS LLP

I. BASICS OF U.S. CHAPTER 11

A. INTRODUCTION

1. Goal of Chapter 11 Process. The goal of chapter 11 is the development and implementation of a plan of reorganization which, when confirmed or approved by the bankruptcy court, becomes the new contract between the debtor, its creditors and equity holders binding upon all parties, whether or not they consent. This new contract – the reorganization plan – typically contains the mechanisms by which the debtor intends to implement a financial restructuring of its balance sheet, including the terms of new financial instruments to be issued pursuant to the plan and the distributions to be provided to creditors and equity holders under such plan.

2. Role of Bankruptcy Court. The formulation of a plan of reorganization is largely a negotiation process in which the Bankruptcy Code provides the parameters of the negotiations. The plan process can become litigious, and the Bankruptcy Code provides the rules for resolving disputes. The Bankruptcy Court effectively supervises this process, provides a forum for parties in interest to voice any disputes and acts as the ultimate arbiter of such disputes.

B. STRUCTURE OF THE U.S. BANKRUPTCY CODE

1. General Provisions. Three general provisions chapters (1,3,5) contain provisions regarding the administration of the bankruptcy estate and creditor claims, what property is contained in the estate, the debtor's powers to augment the estate through recovery of various transfers, etc. and apply in all cases under chapter 7, 11, 12, and 13.

2. Operative Chapters. Five operative chapters: chapter 7-liquidation; chapter 9-municipality, chapter 11-reorganization, chapter 12-family farmer, chapter 13-individual wage earner. This discussion of bankruptcy law focuses on chapter 11 of the U.S. Bankruptcy Code and those provisions of the U.S. Bankruptcy Code which are generally relevant to the administration of a reorganization proceeding under Chapter 11.

C. ELIGIBILITY FOR REORGANIZATION

1. "Persons" Eligible. "Persons" are eligible for chapter 11 protection. Under section 101(41) of the Bankruptcy Code, a "person" is defined to include individuals, partnerships and corporations.

2. Exclusions from Eligibility. Excluded from Chapter 11 relief are domestic insurance companies, banks, savings banks, cooperative banks, savings and loan associations, homestead associations, or credit unions.

3. No Requirement of Insolvency. There is **no requirement under the Code that the debtor be insolvent** or unable to pay its debts as they mature in order to be eligible for voluntary Chapter 11 relief. Most courts impose a good faith requirement - that the debtor have financial problems that require resort to chapter 11.

D. COMMENCING A CHAPTER 11 CASE

1. Voluntary Case. A v**oluntary** chapter 11 case is commenced by filing a petition with the bankruptcy court by an entity that is eligible to be a Chapter 11 debtor. The board of directors must authorize the filing of a bankruptcy petition

2. Involuntary Case. A Chapter 11 case by also be commenced when creditors file an **involuntary petition** against a debtor. The filing of an involuntary petition may be contested.

3. Court Order for Relief. In an involuntary case, the court will enter an **"order for relief"** if no answer is filed within 20 days of the summons. **Conditions § 303(b).** If an answer is filed, the court will enter an order for relief against the debtor under Chapter 11 if the court finds at trial that:

   a. the debtor is generally not paying its debts as they become due, or

   b. that within 120 days before the petition, a custodian was appointed or took possession of substantially all of the debtor's assets.

E. VENUE

1. Choice of Venue. Once the particular kind of proceeding is selected, a venue must be chosen in which to file it. A debtor may only commence a bankruptcy case in the district in which the debtor, for the 180 days immediately preceding the commencement of the case (or for the longest portion of the 180 days if no district meets any of the following qualifications for the full 180 days), had

   a. been domiciled,

   b. a principal place of business or

c. principal assets,

d. a bankruptcy case concerning the debtor's affiliate, general partner or partnership is pending. 28 U.S.C. § 1408(1) & (2).

2. Related Proceedings. **Venue for proceedings related to a debtor's bankruptcy case:** Subject to certain exceptions, proceedings related to bankruptcy cases generally may be commenced in the district court in which the bankruptcy case is pending. 28 U.S.C. § 1409(a).

F. DEBTOR IN POSSESSION

1. DIP as Pre-Existing Entity. The debtor-in-possession (the "DIP") is the same entity which existed before the filing of the bankruptcy petition and is also granted additional powers by the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing. As such, the debtor continues to be managed and controlled by its existing officers and directors.

2. DIP Has Powers of Chapter 11 Trustee. The DIP remains in possession of the debtor's assets and, through its pre-petition management, continues to operate the debtor's business. The DIP has all the rights and powers of a Chapter 11 trustee, as well as all of the duties specified for a Chapter 11 trustee in Section 1106(a). 11 U.S.C. § 1107.

G. THE AUTOMATIC STAY

1. Automatic Stay Arises Upon Filing. Section 362 of the Bankruptcy Code provides that upon the filing of a bankruptcy petition, an automatic stay or injunction arises which prohibits all actions or proceedings against the debtor or its property. The scope of the automatic stay is **broad and it is effective against creditors whether or not they have knowledge of the bankruptcy proceeding**. All actions taken in violation of the automatic stay are void. In re Ward, 837 F.2d 124 (3d Cir. 1988).

2. Violations of Automatic Stay. Violations of the stay may be sanctionable. Knowing violations of the automatic stay may result in an award of damages to the debtor, including costs, attorneys' fees and punitive damages. Section 362(h). Pettitt v. Baker, 876 F2d 456 (5th Cir. 1989); In re Bloom, 875 F.2d 224 (9th Cir. 1989).

3. Actions Enjoined by Automatic Stay. The principal actions enjoined by the automatic stay imposed under section 362 of the Bankruptcy Case upon a chapter 11 debtor's filing for bankruptcy protection include:

(1) all judicial, administrative or other proceedings against a debtor that were or could have been commenced pre-petition or that are based on a pre-petition claim;

(2) enforcement of pre-petition judgments against the debtor or property of the estate;

(3) acts to obtain possession of property of the estate or from the estate; and

(4) acts to create, perfect or enforce liens against property of the estate. A party to a contract cannot notify a debtor that it is unilaterally terminating the contract because of the filing of the debtor's Chapter 11 without violating the automatic stay.

4. Relief from automatic stay. Section 362(d) provides that upon the request of a party in interest and after a notice and a hearing, the court may terminate, annul, modify or condition the stay to allow creditors to exercise their rights against the debtor's property. There are two standards for relief from the automatic stay:

   a. Section 362(d)(1) provides that the stay may be lifted **"for cause"**, including, but not limited to, the debtor's failure to provide the secured creditor with **adequate protection** of its interest in the debtor's property;

   b. The second standard, set forth in Section 362(b)(2), allows the court to grant relief from the automatic stay in favor of a secured creditor if the debtor has no equity in the property and the property is not necessary to an effective reorganization.

5. Adequate Protection. Adequate protection, defined in section 361 of the Bankruptcy Code, is an important concept under the Code which provides that the debtor must protect the secured creditor's collateral from diminution.

   a. The methods of providing adequate protection include cash payments to the creditor, additional or replacement liens, or any other relief as will result in the indubitable equivalent of the creditor's interest in the property.

   b. **Oversecured creditors** are frequently deemed protected by the existence of an equity cushion, i.e., collateral values in excess of the debt. The rationale is that even if the value of the collateral diminishes, the creditor will still receive the value of its claim, the amount of its debt.

   c. **Undersecured creditors**, however, are not entitled to interest or other lost opportunity costs for not being able to enforce its rights as a form of adequate protection. United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd., 108 S.Ct. 626 (1988).

H. CREDITORS' COMMITTEE AND OTHER COMMITTEES

1. The Appointment of Committees. In each Chapter 11 case the United States Trustee appoints a creditors' committee. The committee usually consists of those creditors holding the seven largest unsecured claims against the estate and who are willing to serve. The time within which committees are organized varies depending on local procedures of the United States Trustee's office. The only restriction under the Code is that a creditors' committee be appointed as soon as practicable after the order for relief. 11 U.S.C. § 1102(a) (1).

2. Secured vs. Unsecured Creditors' Committees. An unsecured creditors' committee is appointed in virtually every Chapter 11 case. Secured creditors' committees, however, are rarely appointed because secured creditors hold interests in collateral pools and, therefore, they do not have the same commonality of interest generally experienced by the unsecured creditor body. In some cases, the United States Trustee will appoint a committee of equity holders.

3. Conflict Between Committees. In a Chapter 11 case involving both secured creditors and an unsecured creditors' committees, conflict between such groups is almost guaranteed. Each group has its own distinct interest it seeks to pursue and, quite often, such views are in conflict. Areas of conflict can include whether and to what extent specific creditors are secured by the debtor's assets, valuation, plan formulation and distributions to creditors under a plan. Creditors' committees may also have divergent views upon the actual business which should be pursued by the debtor post-reorganization. Without question, the process of reconciling such conflicts may dictate the ultimate direction of the debtor's Chapter 11 reorganization.

4. Participation on Committee. Participation on a committee is voluntary. Certain types of creditors, such as "insiders" of the debtor, are generally excluded from participation on creditors' committees. The courts have split on the issue of whether an undersecured creditor may participate on an unsecured creditors' committees. Competitors of the debtor are not barred from participation on committees by the Code, but again, the courts are split as to the participation of these creditors on committees. See In re Map Int'l Inc., 105 B.R. 5 (Bankr. E.D. Pa. 1989) (mere fact of competitive status insufficient to remove without evidence of misuse of information).

5. Functions and Powers of Committees. Committee members are fiduciaries for the members of the class they represent. Section 1103(c) sets forth the broad duties of a committee:

   a. consulting with the debtor concerning administration of the case;

b. investigation of the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of the business, and any other matter relevant to the case or formulation of a plan;

c. participation in the formulation of a plan, including giving advice to creditors regarding the plan, and the collection and filing with the court of acceptances or rejections of a plan;

d. requesting the appointment of a trustee or examiner, if appropriate; and

e. performing such other services as are in the interests of creditors.

4. General Role of Committee. In practice, the primary role of the committee is determining whether to permit the debtor to continue operating, negotiating a plan of reorganization with the debtor and gathering information with which to do so, and, on occasions, the committee may propose a plan after the debtor's exclusive right to do so has expired. The committee has the right to challenge a court order and to institute suit. In re A.H. Robins Co., 880 F.2d 769 (4th Cir. 1989).

5. Professionals Engaged by Committee. Committees may select and employ attorneys, accountants, or other professionals to represent or perform services for the committee. Section 1103(a). Such professionals must be retained by the Bankruptcy Court in similar fashion to those professionals which have been retained by the Chapter 11 debtor, and are also paid by the debtor or from the debtor's assets.

I. CONTINUED OPERATION OF THE BUSINESS

1. **Executory Contracts**. Under Section 365 of the Code, the debtor has the option of "assuming" or "rejecting" so-called executory contracts including, but not limited to, unexpired real estate leases.

   a. Assumption. If debtor assumes an executory contract, the debtor and the non-debtor party must perform in accordance with its terms. As a prerequisite to assumption, **the debtor must cure all defaults**, compensate the non-debtor party for any pecuniary loss resulting from those defaults, and provide the non-debtor party with adequate assurance that the debtor will be able to perform under the lease. If continuation of an executory contract is not, based on the debtor's business judgment, beneficial, then the debtor may reject it.

   b. Rejection. Upon rejection, neither the debtor nor the non-debtor party is obligated to fulfill the terms of the contract. Rejection

leaves the non-debtor party with a general unsecured claim against the debtor for damages or a result of the rejection or breach.

2. **Use, Sale, or Lease of Property**

a. In the Ordinary Course of Business. The debtor may enter into transactions, including sales or leases, involving property of the estate, and may use property of the estate in the ordinary course of business without notice or a hearing. 11 U.S.C. § 363(c)(1).

b. Not in the Ordinary Course of Business. The debtor may not use, sell, or lease property of the estate outside of the ordinary course of business without prior court approval on notice to all creditors. Section 363(b). The sale of substantially all of the debtor's assets prior to approval of a disclosure statement and confirmation of a plan is permitted as long as the debtor can show good business reasons for the sale, such as a deteriorating financial condition. In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983).

c. Liens. The debtor may also sell property subject to liens free and clear of those liens, provided there is prior court approval. The liens are transferred to the proceeds of the sale. 11 U.S.C. § 363(f).

3. **Obtaining Credit and Working Capital**. The debtor often obtains working capital through a negotiated cash collateral order with its secured creditor. The debtor may seek to obtain secured financing subsequent to the filing of the petition by granting to a new lender a lien on its assets.

a. Unsecured Credit. Section 364 of the Code governs the obtaining of credit and incurring post-petition debt. Section 364(a) allows the debtor to obtain unsecured credit in the ordinary course of its business without prior court approval. Typically the type of debt incurred under this provision is trade credit. These debts are entitled to a first priority administrative expense and, therefore, are repaid prior to any pre-petition unsecured claims of the debtor and any priority credit incurred by the debtor during the course of its bankruptcy case. The debtor may also obtain unsecured credit out of the ordinary course of business but only after notice and a hearing. 11 U.S.C. § 364(b). These expenses will also be entitled to a first priority administrative expense.

b. Secured Credit. If the debtor cannot obtain unsecured credit allowable as a first priority administrative expense, the court can authorize credit (1) with a priority over all administrative expenses of the kind specified in Section 503(b) or 507(b), or (2) which is secured by a lien on unencumbered property of the estate, or (3)

which is secured by a junior lien on property of the estate that is subject to a lien. 11 U.S.C. § 364(c).

J. MEETING OF CREDITORS

1. 341 Meeting. The Code requires that the United States Trustee convene a first meeting of creditors, and the bankruptcy judge is not permitted to preside or attend. Section 341(c). This meeting of creditors, commonly referred to as the 341 meeting, must be held between twenty and forty days after the order for relief. The debtor must attend the meeting and must submit to examination under oath.

2. Meeting to Form Committee. The 341 meeting is generally limited to informational matters and should be distinguished from the meeting of creditors called by the U.S. Trustee at which a creditors' committee is formed, which often occurs prior to the 341 meeting.

K. CHAPTER 11 TRUSTEE

1. Appointment. In appropriate cases, the court can order that the debtor-in-possession be replaced by a trustee. There are two independent standards for the appointment of a trustee. The first standard, found in Section 1104(a)(1), permits appointment of a trustee **"for cause,"** including fraud, dishonesty, incompetence, or gross mismanagement of the debtor. Section 1104(a)(2) sets forth the **"best interests"** standard for appointment of a trustee. Under that test, a trustee may be appointed if appointment is in the interest of creditors, any equity security holders, and other interests of the estate.

2. Duties and Functions. The Chapter 11 trustee's duties include conducting an investigation of the debtor's conduct, assets, liabilities, and financial condition and filing any statement regarding that investigation. The Chapter 11 trustee also operates the debtor's business (Section 1108) and is charged with the filing of a plan. 11 U.S.C. § 1106(a)(5).

L. EXAMINER

1. Appointment. If a chapter 11 trustee is not appointed, a party in interest may move for the appointment of an examiner. There are two separate standards for the appointment of an examiner.

    a. Section 1104(b)(1) provides for the discretionary appointment of an examiner by the court if appointment is in the best interests of creditors, any equity holders, or other interests of the estate.

    b. Section 1104(b)(2) provides for the mandatory appointment of an examiner if the debtor's fixed, liquidated, unsecured debts, other

than those to an insider, exceed $5,000,000 and a party in interest requests the appointment of an examiner.

2. Duties and Functions. The intended role of an examiner is to investigate allegations of fraud, misconduct, or other irregularities in the operations of the debtor. In some large cases, however, courts have appointed examiners to mediate or monitor negotiations between the debtor and creditors or between various creditor groups in formulation of a consensual plan of reorganization. See, e.g., In re Public Service Company of New Hampshire, 99 B.R. 177 (Bankr. D.N.H. 1989). Such a role is arguably beyond the scope of the statute.

M. CONVERSION OR DISMISSAL OF THE CASE

1. General Rule. A case under Chapter 11 may be dismissed or converted to a case under Chapter 7 of the Code. Under Chapter 7, a trustee is appointed and is charged with responsibility to liquidate the debtor.

2. Conversion to Chapter 7 as of Right by Debtor. Under Section 1112(a), the debtor may convert the case to a case under Chapter 7 as of right unless (1) a trustee has been appointed, (2) the case was originally commenced as an involuntary case, or (3) another party converted the case to a case under Chapter 11.

3. Conversion to Chapter 7 by Party In Interest. Section 1112(b) provides that a party in interest, after notice and a hearing, may dismiss or convert a case under Chapter 11 for any one of several reasons including: (1) continuing loss or diminution of the estate and absence of a reasonable likelihood of rehabilitation; (2) inability to effectuate a plan; (3) unreasonable delay by the debtor that is prejudicial to creditors; (4) failure to propose a plan under Section 1121 within the time fixed by the court; and (5) denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan.

N. CLAIMS AND INTERESTS

1. Claims. A claim is the right to payment of an obligation. Claims may be either secured or unsecured. A secured claim is a claim secured by a lien on property of the estate or a claim that is subject to setoff. Section 506(a). The claim of a secured creditor may be bifurcated in a bankruptcy case into a secured and an unsecured portion. Section 506(a) provides that a claim is secured to the extent of the value of the secured creditor's collateral. The balance of the claim exceeding the value of the collateral is an unsecured claim.

2. Interests. The term interest is not defined in the Code. Interests may include the interests of general or limited partners in a partnership, the

interest of a sole proprietor in a proprietorship or the interests of common or preferred stockholders in a corporation.

O. REORGANIZATION PLAN: FORMULATION

1. Right to File Plan. The debtor has the exclusive right to file a plan for the first 120 days after the entry of the order for relief. Section 1121(b). If the debtor files a plan within the 120-day period, exclusivity is continued an additional 60 days to enable the debtor to obtain the necessary acceptances from each class of claims or interests impaired under the plan. After these exclusivity periods lapse, any party in interest may file a plan. The exclusivity period is terminated earlier by the appointment of a trustee. Section 1121(c)(1).

2. Provisions that Must Be in the Plan. Section 1123(a)(i) of the Bankruptcy Code provides for certain provisions which must be in all Chapter 11 plans:

    a. Designation of Classes. Section 1123(a)(1) requires that a plan designate classes of claims and interests to be treated in the plan. With the exception of administrative expense claims, gap priority claims (those arising in involuntary cases between the petition date and the entry of the order for relief) and priority tax claims, all of which receive mandatory treatment, all claims and interests must be classified by the plan.

    b. Specification of Unimpaired Claims and Interests. Section 1123(a)(2) requires that a plan specify any class of claims or interests that is not impaired under the plan. Section 1124(a)(1) of the Bankruptcy Code provides that a class of claims or interest is impaired under a plan unless, with respect to each claim or interest of such class, the plan leaves unaltered the legal, equitable or contractual rights which such claim or interest entitles the holder of such claim or interest. Thus, if the plan does not alter the "legal equitable or contractual rights" of a claim or interest, that claim or interest is not impaired under the plan. The Chapter 11 debtor is required to disclose this fact specifically.

    c. Specification of the Treatment of Impaired Classes. To the extent that a Chapter 11 plan seeks to modify the "legal equitable or contractual rights" of any class of claims or interests, section 1123(a)(3) requires that such plan specify the treatment of any claims or interests under the plan.

    d. Equal Treatment for Class Members. The plan must provide the same treatment for each claim or interest of a particular class,

unless the holder of a particular claim or interest agrees to a less favorable treatment. Section 1123(a)(4).

e. Adequate Means for Implementation. Section 1123(a)(5) of the Bankruptcy Code requires that the plan provide adequate means for its implementation. That section sets forth a list of illustrative actions which a party may propose in a plan for implementation of the plan, notwithstanding nonbankruptcy law. Most notably, a plan may provide for the sale of "all or any part" of the debtor's assets. Section 1123(a)(5)(D). This provision authorizes "liquidating plans" under Chapter 11. The plan may provide for the merger or consolidation of the debtor with one or more persons. Section 1123(a)(5)(C). The plan may also provide for the issuance of securities of the debtor for cash, property, existing securities or in exchange for claims or interests. Section 1123(a)(5)(J). The issuance of securities by a debtor pursuant to a Chapter 11 plan is exempt from registration requirements under federal and state securities laws. Section 1145.

f. Required Provisions for Corporate Charters Relating to Voting Rights. A plan must provide that the corporate debtor's charter be amended to prohibit the issuance of non-voting equity securities, and that voting power be appropriately distributed among the classes having voting power. Section 1123(a)(6); In re Acequia, Inc., 787 F.2d 1352 (9th Cir. 1986).

g. Selection of Officers, Directors, or Trustees. The plan may contain provisions concerning the selection of officers and directors only if they are consistent with public policy and the interests of creditors and equity security holders. Section 1123(a)(7). The concern of this provision is that management of the reorganized debtor adequately represent those whose investment is involved in the reorganization.

3. Optional Plan Provisions.

a. Assumption or Rejection of Executory Contracts and Leases. A plan may provide for assumption or rejection of executory contracts and unexpired leases to the extent that has not already occurred during the case. 11 U.S.C. § 1123(b)(2).

b. Other Optional Provisions. A plan may also provide for, among other things, (a) the adjustment or enforcement of claims and interests belonging to the debtor, (b) the sale of the debtor's property and distribution of such sale proceeds, and (c) an injunction against non-debtor litigation.

P. THE DISCLOSURE STATEMENT

1. Written Disclosure Statement. Before any party may solicit votes for or against a plan, the court must determine, after notice and a hearing, that the plan proponent has provided a written disclosure statement containing "adequate information." Section 1125(b). Once a disclosure statement has been approved by the court, the plan proponent may solicit acceptances and rejections of the plan. A disclosure statement is intended to serve the same purpose as a proxy statement, insuring that those who vote on the plan have adequate information upon which to base their vote.

2. Adequate Information. Adequate information is defined as "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." Section 1125(a)(1).

3. Requirement of Court Approval. Disclosure statements **may fail to obtain court approval** if they fail to disclose assets or the full range of the debtor's business or if they fail to provide support for valuations or projections. In comparison, the disclosure statement may also fail to obtain court approval if it is too technical and not comprehensible by the average investor.

4. Hearing on Disclosure Statement. At the hearing on the disclosure statement, the court may review the plan or specific provisions of the plan to determine if they are workable. The court may reject a disclosure statement which presents a plan that is not confirmable.

Q. ACCEPTANCE OF THE PLAN

1. Solicitation of Acceptances. Once the court approves a disclosure statement, the plan proponent may solicit acceptances and rejections of the plan. The proponent may bypass the cramdown requirements of Section 1129(b) (see §9.20, infra) if each impaired class votes to accept the plan. 11 U.S.C. § 1129(a)(8).

2. Numerical Requirements for Acceptance by Claims. A class of claims accepts the plan if at least two-thirds by amount and one-half in number of allowed claims in the class, of those actually voting, vote to accept the plan. 11 U.S.C. § 1126(c). In determining acceptances, the claims of insiders are not counted.

3. Votes In Good Faith. At the request of a party in interest and after notice and a hearing, the court may also exclude votes which were not cast in good faith or not solicited or procured in good faith or in accordance with bankruptcy law. 11 U.S.C. § 1126(e). Good faith is not defined by the

Code but has been found to mean generally whether an entity had some ulterior reason or sought to gain some special advantage.

4. Numerical Requirements for Acceptance by Interests. A class of interests accepts the plan if at least two-thirds of the allowed interests actually vote to accept the plan. 11 U.S.C. § 1126(d).

R. MODIFICATION OF THE PLAN

1. Modification Prior to Confirmation. The proponent of a plan may modify the plan prior to confirmation if the modified plan meets the classification requirements of Section 1122 and the mandatory provision requirements of Section 1123.

2. Modification After Confirmation but Prior to Substantial Consummation. Once confirmed, a plan can still be modified to reflect changing circumstances so long as "substantial consummation" of the plan has not occurred, the plan as modified continues to satisfy the classification and plan content requirements of Sections 1122 and 1123, and the court, after notice and a hearing, finds that circumstances warrant the modification and confirms the plan as modified. 11 U.S.C. § 1101(2) and 1127.

3. Substantial Consummation of Plan. A plan is substantially consummated when there has been a transfer of all or substantially all of the property proposed by the plan to be transferred, there has been assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan, and commencement of distribution under the plan has commenced.

S. CONFIRMATION OF THE PLAN

1. The Confirmation Hearing. Section 1128 provides that after notice the court must hold a hearing on confirmation of a Chapter 11 plan. Any party in interest may object to confirmation of the plan. Regardless of whether a valid objection to confirmation has been asserted, the court has an independent duty to determine whether the plan meets all of the requirements for confirmation under Section 1129.

2. Requirements for Confirmation: Consensual Plan. The court may confirm a plan after it determines that the thirteen requirements of Section 1129(a) are met. Section 1129(a)(1) provides that the plan must comply "with the applicable provisions of this title." Generally, under this provision, the courts focus on the classification requirements of Section 1122 and the mandatory provision requirements of Section 1123. However, it is safe to assume that a plan which does not comply with other provisions of the Code may not be confirmable.

3. Requirements for Confirmation: Non-Consensual Plan. Even if all classes of claims and interests do not accept a plan, the court may still confirm the plan upon request of the plan proponent if the plan complies with the "**cramdown**" requirements of Section 1129(b). Under Section 1129(b), a plan may be confirmed over the objection of an impaired non-accepting class if all of the other requirements of Section 1129(a) are met and if the plan does not discriminate unfairly and is fair and equitable with respect to each class that is impaired and has not accepted the plan. A plan does not discriminate unfairly if it protects the legal rights of a dissenting class in a manner consistent with the treatment of other classes with similar legal claims against the debtor.

4. The Fair and Equitable Standard in Cramdown Cases. Section 1129(b)(2) provides a non-exclusive description of "fair and equitable" treatment of dissenting classes. A fair and equitable plan generally requires that each claimant in a dissenting class receive or retain property having a value, as of the effective date of the plan, equal to the allowed amount of its claim, or junior claims or interests cannot participate in the plan or retain any interest. This is sometimes referred to as the "absolute priority rule." Section 1129(b)(2) sets forth guidelines for the fair and equitable treatment of secured claims, unsecured claims, and interests.

   a. **Secured Creditors.** Notwithstanding the dissent of a secured class, the plan may be confirmed if the holder of a secured claim retains its lien securing the claim, whether or not the debtor retains the property or transfers it to another entity, and the holder of the claim receives deferred cash payments totaling the allowed amount of the secured claim which have a present value on the effective date of the plan equal to the value of the collateral.

   Alternatively, the plan may be fair and equitable if the secured creditor realizes the indubitable equivalent of its claim. In one controversial line of cases, the return of the secured creditor's collateral has been held to be the indubitable equivalent of its claim. In re Sandy Ridge Development Corp., 881 F.2d 1346 (5th Cir. 1989).

   b. **Unsecured Claims.** A plan may be confirmed notwithstanding the dissent of a class of unsecured claimants, if the unsecured claimants receive property of a value as of the effective date of the plan equal to the allowed amount of their claims. Alternatively, if the unsecured claimants are not to receive payment in full, the plan must provide that junior claims or interests, such as stockholders, will not receive anything on account of their claims or interests.

   c. **Interest Holders.** A plan may be confirmed notwithstanding the dissent of a class of interests if the holders receive under the plan property with a present value equal to the allowed amount of any

liquidation preference, any redemption price, or the value of the securities, whichever is greater. If the interest holders do not receive such treatment, than no class behind it may receive anything on account of its interests.

5. The Effect of Confirmation. Once confirmed, the plan becomes the debtor's contract with its creditors and equity security holders whether or not they are impaired and whether or not they have voted for the plan. Generally, confirmation of the plan vests all the property of the bankruptcy estate in the debtor, free and clear of all claims and interests except as otherwise provided in the plan or the order confirming the plan. Sections 1141(b) and (c).

T. DISCHARGE OF THE DEBTOR

1. Reflected in the Confirmation Order. The order of confirmation discharges the debtor from any debt that arose before the date of confirmation of the plan (and certain debts arising after confirmation that are deemed pre-confirmation debts) and terminates all interests of equity security holders who were provided for in the plan. 11 U.S.C. § 1141(d)(1). Thereafter, Section 524 of the Bankruptcy Code imposes a post-confirmation injunction against suits on discharged debts.

2. Liquidation Plan Excluded. The confirmation of a plan does not discharge a debtor if the plan provides for the liquidation of all or substantially all of the property of the estate, the debtor does not engage in business after consummation of the plan, and the debtor would be denied a discharge in a case under Chapter 7. Section 1141(d)(3). Thus a corporation may not receive a discharge upon confirmation of a Chapter 11 liquidating plan.

U. IMPLEMENTATION OF THE CONFIRMED PLAN

Section 1142 of the Bankruptcy Code requires that the debtor or any entity organized to carry out the plan carry out the plan and comply with the court's orders despite any otherwise applicable non-bankruptcy law relating to financial condition. The court may direct the debtor and any other necessary party to execute or deliver any document required to effect a transfer of property dealt with by the confirmed plan and to perform any other act, including the satisfaction of any lien, that is necessary for the consummation of the plan.

V. PREPACKAGED CHAPTER 11 REORGANIZATION CASES

1. Introduction. A "prepackaged" bankruptcy case can occur in different forms, but the overriding objective of any prepackaged bankruptcy is the commencement of a Chapter 11 case with the debtor having finalized restructuring agreements with its largest creditors or creditor groups that allows the debtor to paint a picture to its customers and critical vendors that confirmation of the reorganization plan is more or less assured.

2. Prepackaged vs. Traditional Chapter 11 Cases. A prepackaged bankruptcy may significantly reduce the amount of time a debtor needs to spend in a chapter proceeding, as well as give vendors and customers comfort that the debtor can and will achieve a successful outcome. By contrast, a traditional chapter 11 proceeding can strain a customer's operations and may allow competitors to entice the debtor's customers to switch vendors. Prepackaged cases also tend to be shorter than traditional chapter 11 cases – as many key constituencies have effectively agreed to the terms of the restructuring plan – and, therefore, are generally less expensive for the debtor.

3. Prepackaging vs. Out-of-Court Restructurings. Out-of-court restructurings are often the preferred course for companies seeking to deleverage their balance sheets. Generally speaking, however, most debt instruments require the consent of all holders for any significant modifications, such as reductions in principal balances or interest terms or collateral changes. For this reason, holders of small amounts of these debt instruments can holdup a restructuring plan that is supported by the majority of debt. Chapter 11 process allows the debtor to bind the dissenters because the Bankruptcy Code requires acceptance by an affected class holding only two thirds of the amount of debt in such class. As a result, the debtor can isolate any "holdouts" and ultimately restructure its debt consistent with the pre-bankruptcy agreement of holders of a majority of its debt.

4. Variations on Prepackaged Solutions

    a. Dual-Track Prepackaged Case. In this variation, the debtor attempts to solicit acceptances of an exchange offer with its bondholders which will govern if the requisite percentage is reached. That percentage is often 90 percent or higher, but if that percentage is not reached, acceptances of the exchange offer are treated as acceptances of a chapter 11 plan which has only a 2/3rds threshold. As a result, if the requisite percentage for the exchange offer is not reached, the debtor need not spend additional time preparing for a chapter 11 case and soliciting votes on a chapter 11 plan, but can immediately file for chapter 11 with votes already having been solicited on such plan. This type of process can significantly reduce the cost involved in the overall restructuring and speed the debtor's ultimate exit from a chapter 11 proceeding.

    b. Single-Track Prepackaged Case. In this type of case, the debtor negotiates, proposes and solicits acceptances on its chapter 11 plan of reorganization with the singular purpose of intending to file chapter 11 upon completion of a successful solicitation.

    c. Partially Prepackaged Cases. Chapter 11 proceedings may also occur on a partially prepackaged basis where the debtor solicits acceptances from certain select creditors or groups of creditors

prior to filing the chapter 11 proceeding. Partially prepackaged cases may be used where the debtor needs leverage over one group of creditors that is provided by having acceptances of other groups of creditors in-hand prior to filing.

d. Prenegotiated Cases. Prenegotiated chapter 11 cases have become increasingly popular because the debtor can negotiate all of the terms of its plan and obtain the key creditors' contractual agreement – a lockup – to vote in favor of a plan containing such terms, but avoid burdensome U.S. securities law disclosure requirements associated with pre-bankruptcy solicitation of creditors on the terms of an exchange offer or other type of financial restructuring.

5. Risks in a Prepackaged Chapter 11 Case.

a. Claims Trading. Negotiating a prepackaged bankruptcy case has been made more difficult as debt positions are increasingly traded in the public market. As holders of such debt positions change, the debtor must change the party with which it has been negotiating. The new holder of the debt may have a dramatically different view on the pending restructuring proposal and, thus, the value of its claim. For these reasons, a successful prepackaged bankruptcy often requires that a creditor body that is committed to the debtor's restructuring process and willing to hold their claims for the benefit of all parties-in-interest in the restructuring.

b. Involuntary Filing. A debtor's negotiations with its creditors over the terms of a prepackaged Chapter 11 plan could be cut short by an intervening involuntary bankruptcy filing. Dissenting creditors could file an involuntary petition against the debtor as a means of derailing what is perceived as unfavorable or unwanted negotiations over the terms of a plan.

c. No Guarantees. A prepackaged Chapter 11 filing does not guarantee that the debtor will be able to implement that plan in the bankruptcy proceeding. Individual creditors which are not subject to a lockup agreement or that have not already voted in favor of the plan, could challenge the debtor in the proceeding. What the debtor perceives as guaranteed debtor-in-possession financing could be held up or even denied, and dissenting creditors could object to the prepackaged plan on the basis that such plan fails to comply with the applicable legal standards for confirmation. Thus, while the prepackaged bankruptcy plan offers a debtor additional means to put together a successful restructuring under Chapter 11, it does not guarantee that the debtor will ultimately confirm that plan or even emerge from the Chapter 11 proceeding itself.

II. LEASING SPECIFIC BANKRUPTCY ISSUES

A. ASSUMPTION/REJECTION AND CURE DISPUTES

1. **Equipment Leases are "executory contracts"**. Equipment leases generally qualify as executory contracts which may be assumed or rejected by the debtor, unless they are recharacterized as loan transactions as addressed below.

2. **Prerequisites to assumption: debtor must cure**. As a prerequisite to assumption, **the debtor must cure all defaults**, compensate the non-debtor party for any pecuniary loss resulting from those defaults, and provide the non-debtor party with adequate assurance that the debtor will be able to perform under the lease.

3. **Debtor must surrender leased equipment upon rejection.** If continuation of the lease is not, based on the debtor's business judgment, beneficial, then the debtor may reject it. If the debtor rejects the lease, however, neither the debtor [nor the non-debtor party] is obligated to fulfill its respective obligations under the lease. Rejection leaves the non-debtor party with a general unsecured claim against the debtor for damages as a result of the rejection or breach, unless the remedies are otherwise stated in the Bankruptcy Code (see §1110(c)(1)). To the extent that a non-debtor affiliate has guaranteed the lease, the lessor may pursue any and all claims against the guarantor notwithstanding the bankruptcy.

4. **Timing of assumption/rejection decision**. The debtor need not make its assumption/rejection decision until confirmation unless court orders otherwise. However, the debtor is obligated to continue performing under the terms of the lease if and until it rejects the lease. If the debtor fails to perform its obligations under the lease, that may be grounds for the lessor to seek an order from the bankruptcy court compelling the debtor to make its assumption/rejection decision early. Nevertheless, because the debtor can take months and even years before it is required to assume or reject its leases, it is critical for the lessor to actively monitor the debtor's bankruptcy case in hope of finding clues which might telegraph the debtor's intentions with respect to some or all of its leases. The debtor's first day pleadings and any periodic rejection motions the debtor may file during its bankruptcy case are excellent sources of such information. Speaking with the debtor itself or its bankruptcy counsel can also shed light on, among other things, the possible treatment of particular leases or other contracts.

5. **Cure disputes**. Disputes can arise between the debtor and non-debtor concerning the existence and extent of lease defaults. Generally speaking, such disputes are resolved by negotiation among the parties, although a non-debtor party may complain to the bankruptcy court if and when a

debtor refuses to cure or disputes the extent of its cure obligations. Non-debtor parties should be very careful whenever a debtor seeks to assume its leases because the debtor may understate its cure obligations with the bankruptcy court and then attempt to bind the non-debtor party to such understated cure amounts. In that situation, the non-debtor party must file a "cure objection" with the bankruptcy court to protect its full cure claim. The bankruptcy court would then adjudicate such cure claim, unless the parties are able to resolve that objection by agreement.

B. LEASE RESTRUCTURING DURING CHAPTER 11

1. **Leases can be restructured just like loans**. Equipment lease economics change over time. The result of these changing economics may make a particular lease unfavorable to a chapter 11 debtor and, therefore, a likely candidate for rejection. The reasons tend to be very simple: either the debtor cannot afford to continue servicing its current rent obligations under the lease, or the debtor can obtain a new lease for similar equipment on more favorable terms elsewhere. In these types of situations, the lessor has two choices – allow the debtor-lessee to reject the lease and repossess (and redeploy) the equipment, or agree to restructure the terms of the lease. In a restructuring, the lessor often determines it is better to agree to forgive and/or defer future rent and modify other contractual lease terms rather than take back the equipment.

2. **Implementing a lease restructuring**. The debtor generally implements a restructured lease, or restructured lease terms, by assuming the underlying lease, as amended by agreement of the parties to reflect the restructured lease terms. Debtors tend to delay actually assuming the amended lease until they have confirmed their reorganization plan and are ready to emerge from chapter 11 (to avoid the unnecessary creation of administrative liabilities), but debtors also may want the benefit of operating under its restructured lease during the bankruptcy case. As a result, lease amendments tend not to become effective until the debtor is set to emerge from chapter 11 and also sometimes contain, specific "snap back" provisions to recapture rent which was deferred or forgiven pursuant to the lease amendment. This mechanism ensures that the lessor does not waive any claims it might have against the debtor-lessee in the event the debtor fails to confirm its bankruptcy plan or otherwise emerge from chapter 11.

C. SECTION 1110 OF THE BANKRUPTCY CODE

1. **Limitation on automatic stay**. Section 1110 provides for a special exemption from automatic stay unless debtor cures all defaults. In its simplest terms, section 1110 creates an exemption from the automatic stay in that it forces a debtor-airline, within sixty days of filing its bankruptcy petition, to either cure all defaults under its lease documents or allow the

aircraft to be repossessed by the lessor. Assuming that other statutory elements are met, section 1110 permits an eligible lessor, following a 60-day waiting period (as such period may be extended by agreement of the parties), to take possession of the aircraft and enforce any of its other rights or remedies under the applicable lease documentation, notwithstanding any other provision of the Bankruptcy Code, unless the debtor-airline agrees to perform all of its obligations thereunder.

2. **"Surrender and return"**. A debtor who fails to cure must "surrender and return" qualifying aircraft equipment. Pursuant to the provisions of section 1110, if a secured party, lessor or conditional vendor is entitled to possession of the equipment, the trustee or debtor-in-possession is required to immediately "surrender and return" such equipment upon written demand. At such time, any lease, security agreement or conditional sale agreement which constitutes an executory contract is automatically deemed rejected and the aircraft lessor is thereafter entitled to enforce any of its other rights and remedies under the applicable lease documentation, including the right to sell, lease or otherwise dispose of its repossessed equipment.

3. **Section 1110(b) Stipulations**. The 60-day waiting period imposed under section 1110 of the Bankruptcy Code can be extended pursuant to section 1110(b) by agreement of the parties only. The Bankruptcy Court is specifically precluded under the statute from extending the initial 60-day waiting period without the parties' consent. Lessors who are willing to extend the initial "section 1110 period" generally enter into a stipulation with the debtor-lessee pursuant to section 1110(b) of the Bankruptcy Code which provides for the extension of such 60-day period. These section 1110(b) stipulations may also contain other negotiated terms and conditions which make enforceable specific lease terms which are otherwise unenforceable during the bankruptcy. Section 1110(b) stipulations may further provide for deferred or reduced rent, together with specified bankruptcy remedies for the lessor if the debtor fails to comply with lease return conditions. As discussed below, there may be an issue whether, in a leveraged lease situation, the owner participant may extend the section 1110(b) period without the consent of the lease debt or vice versa.

4. **Eligibility for section 1110 protection**. Eligibility for section 1110 protection requires the following: (i) a secured party, lessor or conditional vendor with an eligible security agreement, lease or conditional sale contract (a "Qualifying Financier"); (ii) an aircraft, aircraft engine, propeller, appliance or spare part (as defined in section 40102(a)(38) of title 49) that is subject to a security interest granted by, leased to, or conditionally sold to the debtor ("Qualifying Equipment"); (iii) a debtor that at the time the transaction was entered into held an air carrier operating certificate issued pursuant to chapter 447 of title 49 for aircraft

capable of carrying 10 or more individuals or 6,000 pounds or more of cargo; and (iv) an underlying agreement which gives the Qualifying Financier certain rights such as the right to take possession, sell, lease or otherwise retain or dispose of the Qualifying Equipment upon an event of default.

D. RECHARACTERIZATION: TRUE LEASE VS. DISGUISED SECURED FINANCING

1. **Significance of distinction**. The legal ramifications of this distinction are many. As noted above, leases are entitled to special protections, and lessors are afforded special rights, in a bankruptcy case. If a debtor decides to assume an equipment lease, the debtor must cure any prepetition and/or postpetition defaults under the lease. Under section 365(d)(10), after the expiration of an initial 60-day relief period, the debtor is also required to make rent payments to equipment lessors in the amount required under the lease. By contrast, secured creditors only have a secured claim to the extent of the value of its collateral. As a result, if a lease is ever determined to be a secured claim and the secured party is undersecured (i.e., the amount of the claim is greater than the value of the collateral), the claim will be bifurcated into a secured claim - but limited to the value of the collateral - and an unsecured claim for the balance. From there, the debtor may seek to "cram down" a plan of reorganization by stripping the lien down to the value of the collateral and paying it off over a period of years. Additionally, undersecured creditors are not entitled to interest on the secured component of their claims. For these reasons, disputes often arise concerning the proper legal classification of an equipment finance transaction: true lease or disguised financing.

2. **State law governs**. Whether a transaction constitutes a true lease or a disguised financing to or from that entity will be determined not by the provisions of the Bankruptcy Code, but instead by applicable state law. Thus, if a bankruptcy court were to determine that a lease transaction was a secured loan, it can recharacterize that transaction as a secured loan and the lessor will lose the protections afforded to lessors under the Bankruptcy Code and the debtor's obligations under the lease will be treated as a typical finance transaction.

3. **Fact specific analysis required**. Judicial reasoning in decisions which analyze the issue of whether a given transaction constitutes a true lease or a secured loan tends to be fact specific. As explained by Carolyn Hochstadter Dicker and John P. Campo in their ABI Law Review article *FF & E and the True Lease Question: Article 2A and Accompanying Amendments to UCC Section 1-201(37)*(hereinafter, *True Lease Question*), "the focus of the analysis [of whether a lease is a true lease] is to determine whether the parties to the lease anticipated that any significant value would remain in the leased property for return to the lessor at the

end of the lease term, and whether such value is returnable through the lessee's own free will." 7 ABI L. Rev. 517, 518 (1999).

4. **Parties' intent begins analysis**. Courts generally focus on the intent of the parties in conducting their recharacterization analysis, but often limit their examination to the objective, rather than subjective, intent of the parties. See In re Wingspread Corp., 116 B.R. 915, 922 (Bankr. S.D.N.Y. 1990) ("Wingspread") ("The proper focus of [the] inquiry centers on the objective intent of the parties."); also, In re Wedtech Corp., 72 B.R. 464, 474 (Bankr. S.D.N.Y. 1987) ("Wedtech") (same). As a practical matter, this examination results in an analysis of the economic substance of the transaction. See Id.; Wingspread, 116 B.R. at 922 (analyzing economic substance of transaction); Wedtech, 72 B.R. 464, 474 (Bankr. S.D. N.Y. 1987) (same).

5. **Economic substance of transaction key.** Courts have applied an economic substance analysis to recharacterize a lease as a disguised financing upon finding that the economic substance of the transaction is not of the type associated with a true lease. These courts have identified various factors as indicative of the economic substance of an agreement and generally survey all relevant factors, with no one factor controlling. The following factors are those most frequently cited:

    a. whether rent payments are calculated to ensure a return on the lessor's investment or are, in fact, payments of principal and interest, rather than mere compensation for the use of the property, In re Hotel Syracuse, 155 B.R. 824, 839 (N.D.N.Y. 1993) ("Hotel Syracuse") (fact that rent is calculated to reflect current and future payments on underlying mortgage suggests that lease transaction in fact was a loan);

    b. whether the lessee is required to purchase the property upon the occurrence of certain events, In re Winston Mills, Inc., 6 B.R., 587, 594-95 (Bankr. E.D.N.Y. 1980) ("lease" was a lease intended as security where, inter alia, "rent" reflected payments of principal and interest, and lessee was required to purchase leased property in event of condemnation, casualty, or significant "change in circumstances");

    c. whether the agreement transfers to the lessee risks and obligations of ownership--such as, the responsibility for payment of property taxes, maintenance and repair of the property, and maintenance of insurance--which normally are possessed by the lessor, Liona Corp. v. PCH Assocs., 804 F.2d 193, 201 (2d. Cir. 1986) ("PCH Assocs.") (fact that lessee "assumed many of the obligations associated with outright ownership of the property, including

responsibility for paying property taxes and insurance" suggests that lease was a disguised security agreement);

d. whether the lease provides the lessee with an option to purchase the assets for nominal or minimal consideration, Wingspread, 116 B.R. at 923 (factors that indicate a transaction is a financing lease include "(i) an option price bearing little resemblance to fair market value [and] (ii) an option price that is minimal in comparison with total payments");

e. whether the lessor purchased the property specifically for the lessee's use, In re Hotel Syracuse, 155 B.R. at 838;

f. whether the lessor obtained credit to purchase the leased property, with the lease term ending when the loan is due, In re Best Products Co., Inc., 157 B.R. 222 (Bankr. S.D. N.Y. 1993) (sublease coterminous with sublessor's secured debt); and

g. whether the transaction was structured as a lease instead of a loan to secure tax or other benefits, In re Hotel Syracuse, 155 B.R. at 838.

E. EQUITY SQUEEZE RIGHTS

1. **Critical issue in bankruptcy**. In a leveraged lease, contractual equity squeeze rights or protections unquestionably improve the lessor's negotiating leverage in a bankruptcy. To the extent that the lease debt (or its indenture trustee) must obtain the consent of the lease equity (or its owner trustee) to restructure the lease terms, the lease equity (i.e., the owner participant) can insist on a seat at the negotiating table when the lessee and the lease debt seek to restructure the terms of the lease. Participation in the process is crucial for the lease equity to protect its economic interest in the equipment as well as for the lease equity to preserve many of the legal rights it was promised when the lease transaction was consummated. Without squeeze rights, the lease equity may be kept in the dark when these negotiations take place and, therefore, has no voice on the new rent or other lease terms. In these situations, the lease equity can raise objections with the bankruptcy court but these objections are rarely sustained unless the parties have acted in a commercially unreasonable manner or otherwise not in good faith.

2. **Foreclosure may still be a risk**. Owner participants that do have equity squeeze rights must remember that the lease debt will ultimately have the ability to foreclose on the equipment and may even have the right to then release it to the debtor. The owner participant may suffer substantial adverse tax consequences if the lease debt elects to exercise its foreclosure rights. As such, lease equity must carefully balance this risk when

negotiating the new terms of the restructured lease or lease amendment with a lessor-debtor and the lease debt.