Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

What To Know About Drafting Ch. 11 Disclosure Statements

Law360, New York (August 07, 2013, 6:08 PM ET) -- In order for creditors and interest holders to make an informed judgment regarding a proposed Chapter 11 plan, the Bankruptcy Code requires that a disclosure statement be filed, approved and disseminated to stakeholders prior to the stakeholders voting to accept or reject the plan. The disclosure statement is necessary to provide parties with context for the Chapter 11 plan, to help stakeholders understand their projected recoveries under the plan, and to assist the stakeholders in evaluating whether the plan is appropriate under the circumstances.

Requirement to be Filed with Plan

Pursuant to Section 1125(b), a plan proponent cannot solicit votes on a plan from a holder of a claim or interest until the plan proponent transmits: (1) a plan or a summary of the plan, and (2) a written disclosure statement approved by the court after notice and a hearing as containing adequate information to the holder of the claim or interest.

Pursuant to Federal Rule of Bankruptcy Procedure 2002(b), all parties-in-interest must receive by mail at least 28 days' notice of: (1) the deadline for filing objections to the disclosure statement and (2) the hearing to either consider approval of the disclosure statement or to make a final determination regarding whether the plan provides adequate information so that a separate disclosure statement is not necessary.

Federal Rule of Bankruptcy Procedure 3016(b) provides that the disclosure statement should also be filed at the time of the filing of the plan or within a time fixed by the court.

In practice, to move the case along as expeditiously as possible, it is not uncommon for a plan proponent to file a disclosure statement that is missing certain pieces of information with the intent of supplementing the disclosure statement prior to the hearing to approve the disclosure statement.

For example, the initially filed disclosure statement may not include a liquidation analysis or a description of other items that may still be subject to negotiation among the constituencies. While the circumstances may vary, in most large or complex cases, courts are generally flexible in permitting such supplementary disclosures.

Contents of a Disclosure Statement

In order to approve a disclosure statement, a court must find that the disclosure statement contains adequate information for a hypothetical investor typical of holders of claims or interests of each class to make an informed decision about whether to vote to accept or reject the plan.

Section 1125(a)(2) defines an "investor typical of holders of claims or interests of the relevant class" as an investor having:

- A claim or interest of the relevant class;
- The same relationship with the debtor as the holders of the claims or interests of the relevant class generally have; and
- The same ability to get information from other sources as the holders of the claims or interests of the relevant class.

Section 1125(a)(1) provides that the disclosure of information must be reasonably practicable in light of the condition of the particular "debtor's books and records, including a discussion of material federal tax consequences of the plan to the debtor, any successor to the debtor and a hypothetical investor typical of the holders of claims or interests in the case."

To determine whether a disclosure statement includes adequate information, Section 1125(a)(1) requires the court to consider the:

- Complexity of the case;
- Benefit of additional information; and
- Cost of providing additional information.

While this standard is intentionally flexible, in all instances, the disclosure statement should include a liquidation analysis of the debtor that analyzes the recoveries of each class of claims and interests under a hypothetical Chapter 7 liquidation. Parties-in-interest, as well as the bankruptcy court, will use the liquidation analysis to make decisions regarding the plan and whether reorganization or liquidation serves the best interests of the creditors and interest holders.

A disclosure statement does not, however, generally need to include information about any other possible or competing plan.

The following is a nonexclusive list of items that should be included in a disclosure statement:

- A background concerning the debtor's company and the events preceding the bankruptcy;
- A description of the Chapter 11 case;
- A summary of the Chapter 11 plan;
- An explanation of risk factors related to the plan;
- Provisions detailing any securities laws matters related to the plan;
- A discussion of pending or threatened litigation;
- Financial projections and valuation information related to the debtor, including explanations of the assumptions relied upon to make such projections and valuation;
- An explanation of tax consequences resulting from implementation of the plan;
- Provisions describing the solicitation and confirmation process, including balloting information and an explanation of the requirements for confirmation under the Bankruptcy Code;
- Provisions detailing alternatives to confirmation and consummation of the plan;
- Information regarding claims against the debtor;
- Information about management; and
- A liquidation analysis.

Objections to Disclosure Statement

In larger Chapter 11 cases, the filing of a disclosure statement often triggers numerous objections by various creditors, equity security holders and other parties-in-interest. These objections will be many and varied, particularly in large and complex bankruptcy cases, and may include such objections as to:

- The adequacy of the disclosure of the treatment of classes and the approximate amount or percentage creditors will receive on account of their claims;
- The adequacy of the disclosure of what creditors would receive in the liquidation; and
- The adequacy of the description of the implementation of the plan and its feasibility.

See, for e.g., In re Tribune Co., No. 08-13141 (KJC), at *51-52 n.31 (Bankr. D. Del. Oct. 31, 2011) (considering the objection of the U.S. Department of Labor, which was among myriad other objectors and argued that the debtors' first disclosure statement did not give ample disclosure of the agency's investigation into the debtors' 2007 leveraged buyout).

Recognizing that it is easier for a court to assess objections to a disclosure statement by reviewing alternative or supplemental disclosure, some local rules require any objection to include the language of the proposed disclosure that would remedy such objection. At the same time, courts generally do not give much weight to disclosure objections relating to minute issues relevant to just one or a few relatively insignificant creditors and instead, require disclosure when applicable more broadly.

In order to address a large number of objections, the debtor may respond to similar objections in an omnibus response that addresses all of the concerns of the similar objections in one filing. The debtor may also respond to different kinds of objections in one response.

Such a response is typically divided into sections that respond to each type of objection. Additionally, the response often includes a chart that summarizes the objection and the debtor's response to the objection, including any revisions that the debtor has made to the disclosure statement to address the objection.

In a contested Chapter 11 case, objections to disclosure statements also may provide a party its first opportunity to raise challenges to the debtor's Chapter 11 plan on the record. Therefore, many disclosure statement objections may include objections to the confirmation of the plan. While such objections may be deferred by the court to be dealt with at the confirmation hearing, the objectors will use the disclosure statement hearing as a platform to educate the court on potential infirmities of the debtor's plan.

In addition to filing written responses to objections, the plan proponent will often make a presentation at the disclosure statement hearing regarding the adequacy of its disclosure and address each response, or at least, each type of response. Plan proponents will typically negotiate with objectors prior to the disclosure statement hearing about whether to include additional disclosure or modify the existing disclosure.

To the extent the parties have come to any agreements about revisions to the disclosure statement, the plan proponent will explain them to the court, after which the objectors will have an opportunity to respond, and the court will rule as to whether the disclosure is adequate. The court may also suggest, sua sponte, certain revisions to the disclosure statement and may rule that the disclosure will be adequate once those changes are made.

Small Business Cases and Conditional Approval

Section 1125(f) contains several provisions with respect to disclosure requirements in small business cases that are intended to lessen the burden on the small business debtor.

For example, pursuant to Section 1125(f)(1), the court may decide that a separate disclosure statement is not necessary because the plan itself provides adequate information. In these cases, the court may allow a small business to forgo the time and expense of preparing a disclosure statement because the small business debtor has a much less complicated structure than a large business and it is able to adequately disclose its financials in its Chapter 11 plan.

Pursuant to Section 1125(f)(2), the court may approve a standard form of disclosure statement for small business cases. The Judicial Conference of the United States provides the form of a disclosure statement that a small business debtor may use pursuant to this section.

The form provides a clear and easy-to-use format for the debtor to present its disclosure statement, which balances the reasonable need for information of the parties-in-interest with the debtor's need for economy and simplicity. The form is organized into sections, contains explanatory text, provides suggested language and indicates where the debtor must insert information. The form highlights the factual and legal disclosures required by Section 1125, but encourages the debtor to provide any more information that would be useful to other parties.

In addition, pursuant to Section 1125(f)(3)(A), the court may conditionally approve a disclosure statement, subject to final approval after notice and a hearing. In such a case, the small business debtor must transmit the conditionally approved disclosure statement at least 28 days before the confirmation hearing. The final hearing on the disclosure statement may be combined with the confirmation hearing.

—By Gary L. Kaplan, Fried Frank Harris Shriver & Jacobson LLP

Gary Kaplan is a bankruptcy and restructuring partner resident in the New York office of Fried Frank Harris Shriver & Jacobson LLP.

This article is excerpted from Lexis® Practice Advisor, a comprehensive practical guidance resource providing insight from leading practitioners on the topics critical to attorneys who handle transactional matters. For more information on Lexis Practice Advisor or to sign up for a free trial please click here. Lexis is a registered trademark of Reed Elsevier Properties Inc., used under license.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

All Content © 2003-2013, Portfolio Media, Inc.