New Central District Bankruptcy Rules Aim To Prevent 'Procedural Roulette"

By David M. Reeder
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A newly enacted General Order of the United States Bankruptcy Court for the Central District of California may result in local companies filing their substantial chapter 11 cases in the local bankruptcy court, rather than choosing other venues. In the past several years, practitioners before the United States Bankruptcy Court for the Central District of California have stood by while many large bankruptcy cases which could have been filed in Los Angeles found their way into the United States Bankruptcy Courts for the District of Delaware or the Southern District of New York. While the reasons for this corporate bankruptcy out-migration are many-fold and complex. One of the major considerations has been the perception that chapter 11 business cases fared better in foreign jurisdictions during the critical first several weeks of the case.

In those courts, "first day orders", providing for critical matters such as payment of pre-petition wages, use of cash collateral, employment of counsel, and sale of assets, were heard and dealt with promptly by courts amenable to fast action as the case got off of the ground. Local practice in those courts made first day orders an accepted part of practice. This, in turn, made the ensuing process predictable.

The bankruptcy court for the Central District of California encompasses Los Angeles, Orange, Riverside, San Bernardino, Ventura, Santa Barbara and San Luis Obispo counties, and consistently leads the nation in the volume of chapter 11 cases. In the Central District, there has been, up now, no uniform procedure for the bar to follow regarding first day orders. In the perception of many practitioners, this has caused large, high-stakes chapter 11 cases to be filed in venues where counsel could get critical matters before the court almost immediately after filing the case.

Under the venue provisions pertaining to bankruptcy cases, a company may file a chapter 11 case in any district where it has its residence, domicile, principal place of business, the location of its principal assets, or where a bankruptcy case of an affiliated company is pending. 28 U.S.C. § 1408. Delaware is an available bankruptcy venue for many Southern California companies due to the fact that they are Delaware corporations.

To understand why a difference in a procedural matter such as first day orders could have such a far-reaching effect, some background on the procedural hurdles that faced debtor's counsel in the Central District is appropriate.

Requests for first day orders come under the general rubric of motion practice as controlled by the Local Bankruptcy Rules for the United States Bankruptcy Court for the Central District of California (the "Local Bankruptcy Rules" or "LBR"). Under the Local Bankruptcy Rules, motions generally require 24 days written notice to creditors and other parties in interest. LBR 9013-1(1)(f)(ii). Counsel wishing to bring a matter before the court on less than this amount of notice was required to follow the procedures under either LBR 9075-1(1)(emergency motions – less than 48 hour notice) or LBR 9075-1(2)(motions heard on shortened notice).

Matters which needed to be handled on an emergency basis required counsel for the moving party to contact a member of the court's staff and "pitch" the nature of the emergency. The court, after hearing the staff member's rendition of counsel's plea for an emergency hearing, would inform counsel, through staff, as to whether this particular emergency met the court's standard of a true emergency. A positive answer from the Court resulted in the matter being set for hearing on less than 48 hours notice. If the Court was not convinced that an emergency existed, then counsel's choices were to either file a separate motion for a hearing on shortened notice, or to set the matter for hearing on the regular 24 day notice.

Per LBR 9075-1(2), motions for an order shortening time ("MOST") required that the underlying motion, and all declarations and exhibits, accompany the MOST. The court, based on its perception of existence of the necessity for a hearing on shortened notice, would either grant or deny the MOST. In the eyes of many practitioners, the bankruptcy judges in the Central District often had a restrictive view regarding the necessity of shortened notice. The judges likewise expressed frustration about being deluged with "emergency" motions where the emergency was more a product of counsel's or the client's impatience than a real need for an expedited hearing. This caused a dilemma for counsel, because if he/she prepared and filed a MOST, and it was denied, precious days were lost, and counsel, in hindsight, might have fared better simply by setting the motion with standard 24-day notice.

Beyond the requirements of notice was a more practical problem: finding a hearing date on the court's calendar. Although a majority of bankruptcy courts have adopted a self-calendaring system, there are still courts which require counsel to clear a calendar date with the court's staff. There have been times when the court's calendar was such that matters arguably entitled to shortened notice could not be heard until more than 30 days after the request for a hearing date. Given the fast pace endemic to the early days of a substantial chapter 11 case, attorneys and companies were hesitant to take such risks.

The advent of General Order 02-02 of the United States Bankruptcy Court for the Central District of California (the "GO"), signed by Chief Judge Geraldine Mund on April 17, 2002, however, changes the playing field in chapter 11 cases. The GO provides for a uniform method for bringing first day motions before the

bankruptcy court. Under the GO, specifically enumerated motions may be brought on less than 2 days notice. These include motions for authorization to pay pre-petition payroll, comply with customer obligations and deposits, establish provisions regarding payments to utilities pursuant to 11 U.S.C. § 366, use cash collateral, and to establish sale procedures for all or substantially all of the debtor's assets.

The GO sets out uniform procedures for the required contents of, noticing of, and calendaring of hearings for motions for 1st day orders. Additionally, the GO provides a long-awaited uniform procedure for dealing with the confirmation of pre-packaged plans of reorganization already approved by creditors prior to the filing of the bankruptcy case. The general order also provides for confirmation hearings on pre-packaged plans to be scheduled, if practicable, not more than 30 days after the filing of the case. This provision alone will go a long ways toward putting Los Angeles on equal footing with Delaware and New York. Prior practice in the Central District of California was to treat pre-packaged plans as no different from any other plan of reorganization, requiring the approval of a disclosure statement after 36 day notice, solicitation of acceptances from creditors, and plan confirmation hearing not less than 24 days notice.

Cases with pre-packaged plans are normally highly orchestrated, with lenders or merger partners standing by to fund the plan upon confirmation by the court. Tensions, however, often run high, and a goal of the parties in such cases is to confirm the plan and fund the reorganization before the economics change for the worse, or a key player's perception of the transaction changes. Thus, the GO provides for a way for companies who have agreed with their creditors on the terms of a plan outside bankruptcy to accomplish the fait accomli within the bankruptcy process.

The GO also expedites sales of all or substantially all of the debtor's assets. When a company files a chapter 11 case, often a speedy sale of its assets, to a buyer ready to pay cash, offers the best return for creditors. To further this end. the GO provides that a motion for an order establishing sale procedures can be set on 5 court-days notice. The actual hearing on the sale will be no more than 30 days after the hearing on the sale procedures motion. The sale procedures motion allows the sale, which will be subject to overbid, to be conducted in an orderly manner, and provides for such items as the amount of break-up fees, the amount and deadline for deposits from potential over bidders, the amount of the first overbid and the increments in which bidding will take place, and other matters critical to an orderly sale.

With a new procedure in which parties to a chapter 11 case can be assured that first day motions will find their way before the court, the "procedural roulette" which confronted counsel in attempting to get a chapter 11 case up and running will become a thing of the past. Only time will tell whether these new uniform procedures will stem the flight of local corporate chapter 11 cases. It is clear, however, that the Bankruptcy Court for the Central District of California has

taken a major step toward balancing the interests of due process and notice with the acknowledged need for speedy disposition of matters during the critical early days of a chapter 11 case.

The GO was facilitated by the efforts of numerous bankruptcy judges and a working group of the Bankruptcy and Commercial Law Section of the Los Angeles County Bar Association. A copy of General Order 02-02 appears on the website for the United States Bankruptcy Court for the Central District of California at www.cacb.uscourts.gov.

David M. Reeder is an attorney with 27 years of experience focused on bankruptcy cases, business reorganizations, bankruptcy litigation, loan workouts, bankruptcy trustee representation, and the representation of purchasers of distressed assets. He can be contacted at david@reederlaw.com.