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Chapter 11 Bankruptcy Tools and Tactics

Kenric D. Kattner
Haynes and Boone, LLP
Houston, TX

David L. Staab
Haynes and Boone, LLP
Fort Worth, TX

Kenric D. Kattner
Haynes and Boone, LLP
1221 McKinney Street, Suite 2100
Houston, Texas 77010
kenric.kattner@haynesboone.com
713.547.2518

David L. Staab
Haynes and Boone, LLP
301 Commerce St, Suite 2600
Fort Worth, Texas 76102
david.staab@haynesboone.com
817.347.6645

I. INTRODUCTION

The general purpose of the Bankruptcy Code is to provide an honest debtor with a fresh start while promoting equality of distribution among creditors. Chapter 11 of the Bankruptcy Code expands on these policies with a preference for reorganization over liquidation, which has the added benefits of maintaining jobs and fostering continued business operations by both the debtor and its creditors. Increasingly, various provisions of the Bankruptcy Code have been used tactically to achieve important business goals to further mergers, acquisitions, corporate takeovers, debt modifications, settlement of judgments, and balance sheet restructurings to name a few. The Bankruptcy Code is a flexible statute that can be adapted to achieve these purposes in a multitude of very challenging situations. This paper identifies and explains a selection of Bankruptcy Code provisions and discusses how they can be used tactically to achieve important business objectives.

II. STRATEGIC USE OF THE AUTOMATIC STAY

One of the immediate consequences of filing a bankruptcy petition is the imposition of the “automatic stay.” The automatic stay is governed by Bankruptcy Code § 362, which provides that filing a bankruptcy petition operates as a stay, applicable to all entities, of –

- (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the [bankruptcy case], or to recover a claim against the debtor that arose before the commencement of the [bankruptcy case];
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the [bankruptcy case];
- (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
- (4) any act to create, perfect, or enforce any lien against property of the estate;
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the [bankruptcy case];
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the [bankruptcy case];
- (7) the setoff of any debt owing to the debtor that arose before the commencement of the [bankruptcy case] against any claim against the debtor; and
- (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable

period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.¹

Courts have explained that the purpose of the automatic stay is “to prevent certain creditors from gaining a preference for their claims against the debtor; to forestall the depletion of the debtor’s assets due to legal costs in defending proceedings against it; and, in general, to avoid interference with the orderly liquidation or rehabilitation of the debtor.”² While the automatic stay does indeed serve these broad bankruptcy policies, it may also serve as a litigation tactic for certain debtors—the automatic stay is essentially a broad injunction; it can stop judgments, foreclosures and executions, and may also present a cheaper alternative to filing a supersedeas bond.

A supersedeas bond allows a judgment debtor to stay execution of a judgment and pursue an appeal.³ In federal court, the stay does not take effect until the court approves the bond.⁴ The required amount for the supersedeas bond varies by jurisdiction, but generally speaking, a supersedeas bond for a money judgment must equal the amount of compensatory damages, plus interest and fees.⁵ Therefore, a supersedeas bond for a large judgment can impose a substantial financial burden on a judgment debtor.

In situations where the judgment debtor cannot afford a supersedeas bond or when execution on the judgment is eminent, the automatic stay will stop execution on the judgment and allow the appeal to proceed without the judgment debtor having to obtain a supersedeas bond. An example of this tactic is the Texaco bankruptcy. Texaco filed bankruptcy in April of 1987 to obtain injunctive relief and prevent Pennzoil from executing on a judgment in excess of \$11 billion.⁶ At the time, the Pennzoil judgment against Texaco was the largest civil judgment in history, and the Texaco case was the largest bankruptcy ever filed.⁷ In the underlying cause of action, the jury found that Texaco knowingly and intentionally interfered with Pennzoil’s attempted acquisition of Getty Oil Co.⁸ In order to stay execution of the judgment pending an appeal, Texaco would have been required to post a supersedeas bond, payable to Pennzoil, of more than \$12 billion.⁹ Texaco did not have sufficient liquid assets to post the bond and maintain its business operations.¹⁰

Instead, Texaco was able to utilize the Bankruptcy Code’s automatic stay as an injunction immediately upon filing the bankruptcy petition and prevent Pennzoil from executing its judgment. In addition to the financial benefits from not having to post a \$12 million bond, Texaco obtained leverage in terms of settlement negotiations. Less than a year after the

¹ 11 U.S.C. § 362(a)(1)-(8).

² *St. Croix Condo Owners v. St. Croix Hotel*, 682 F.2d 446, 448 (3d Cir. 1982).

³ See Fed. R. Civ. P. 62(d).

⁴ *Id.*

⁵ See generally Tex. R. App. P. 24.2(a)(1).

⁶ *In re Texaco Inc.*, 84 B.R. 893, 894 (Bankr. S.D.N.Y. 1988).

⁷ *Id.*

⁸ See *Texaco Inc. v. Pennzoil Co.*, 784 F.2d 1133, 1136 (2d Cir. 1986).

⁹ *Texaco Inc. v. Pennzoil Co.*, 784 F.2d at 1138.

¹⁰ See *id.*

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