A Chapter 11 Debtor’s Life after Oct. 17: Not So Bad if You Effectively Plan

Written by
Michelle M. Harner
JenseyDally/Chicago
mharner@jndlegal.com
Carl E. Black
JenseyDally/Cleveland
cblack@jndlegal.com

The adoption of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) sparked a considerable measure of consternation among bankruptcy professionals who represent corporate chapter 11 debtors. The initial consensus appeared to be that BAPCPA would dramatically and (from a debtor’s perspective, negatively) change the chapter 11 landscape, much to the consternation of many observers who predicted a tidal wave of filings to beat its Oct. 17 general effective date. But now that Oct. 17 has come and gone, will the real life be that bad for a chapter 11 debtor? Life certainly will be somewhat different, but whether it will be markedly worse is a question open to debate.

Most professionals agree that the business provisions of BAPCPA assist certain creditor groups, perhaps at the expense of the direct creditors of the chapter 11 debtor. Nonetheless, an agreement can be made that with more advanced planning, careful analysis and effective lawyering, life may not be so different, or at least all that bad, for a chapter 11 debtor under BAPCPA. For example, encouraging a debtor to complete its court-supervised restructuring in 18 months (i.e., the debtor’s maximum exclusive period to file a plan under BAPCPA) may not necessarily be a bad thing; it may just mean that we see more “pre-packaged” and “pre-arranged” bankruptcies, which could lead to more cost-effectiveness restructuring. Granted, there are some exceptions to the rule, and these will be cases where 18 months is simply not long enough or where simply was not sufficient time pre-petition to plan effectively for the restructuring generally, and deal diligencing in particular. Under certain key provisions of BAPCPA, such as those relating to claim reaffirmation rights, administrative claims and property leases, utilities, key-employee retention programs and executivity. As discussed below, however, paying attention to the following three key cases, there will likely be ways to mitigate the impact of these provisions, and a chapter 11 debtor’s life under the BAPCPA, likely will be manageable.

Reclamation Claims and Administrative Claims for Goods
(BAPCPA Rev Code §506(c))

In BAPCPA Rev Code §506(c) expands the universe of goods subject to reclamation to include all goods received by the debtor in the 45 days prior to the petition date and requires the debtor either to return any goods subject to valid reclamation claims (explicitly or implicitly or for the purpose of complying with a confirmed plan. In fact, the Code complements §546(c) by providing suppliers with an administrateur claim equal to the value of any goods received by the debtor in the ordinary course of its business within 20 days prior to the petition date. These expanded reclamation rights and administrative claims also provide suppliers with additional protection against post-petition actions on account of payments made to such suppliers in the 45 days preceding the petition date.

The suppliers begin celebrating, however, they should consider that a revised §546(c) of the Code does not call for reclamation claims to be resolved on a shortened timeline (b), there are no exceptions from the automatic stay for reclamation claims, (c) there are no provisions expressly negating established case law governing what constitutes a valid reclamation claim, (d) any pre-reclamation rights that they may have are expressly subject to the prior rights of a holder of a security interest in the goods (e) there is no requirement that administrative claims be paid other than in connection with a confirmed plan. In fact, some commentators have argued that the impact of revised §546(c) likely will be mitigated completely by the liens of the debtor’s pre-petition lenders. Accordingly, although it is the potential realization of real property leases, utility, key-employee retention programs and executivity. As

Adopted

With the consent of individual lessors. The impact of this provision, however, may be limited with advance planning and creativity. For example, a debtor might develop a strategy that (a) pre-petition, classify its leases into the following three key categories: (i) leased properties that are vital to the reorganization (or the reorganization efforts) and should reasonably be presumed to be valid (ii) leasehold properties that are unnecessary to the reorganization and unlikely candidates for an assignment (e.g., above-market leases) and should be rejected as soon as possible, and (iii) leased properties that are unnecessary to the reorganization but likely candidates for an assignment (e.g., below-market leases) which will either be assumed or rejected during the applicable period; and (b) post-petition, involving the filing of a motion to establish procedures for the assumption, assignment and rejection of leases.

Any post-petition procedures motion should seek to clarify the debtor’s ability to assume a lease during the §365(d)(4) period and then subsequently assign the lease in accordance with §365(f). The ability to assign assumed leases may assist the debtor in

in complying with the deadline set forth in revised §365(d)(4) while still developing and then implementing a business plan that maximizes the value of its lessorships.

In addition, a debtor whose business is seasonal should consider when the applicable period will expire in connection with the needs of its business and, to the extent possible, file its filing accordingly to avoid or mitigate any related interruption of its business.

Another possible strategy often mentioned by commentators would involve moving leases into a special-purpose vehicle that could be placed into bankruptcy at a later date by the debtor, thereby begging the non-applicability of the control of when the §365(d)(4) period commences. Although facially appealing, this latter strategy has the potential to raise fraudulent-conveyance and financing issues, among others, and would require careful planning and implementation.

Adequate Assurance for Utilities

Although revised §366 of the Code ups the ante when it comes to adequate assurance for utilities by (a) requiring a debtor to provide cash, letters of credit, surety bonds or similar security (potentially at great expense to the debtor) and (b) permitting a utility to terminate service within 30 days after the petition date if the utility does not receive adequate assurance, utilities likewise do not hold all of the cards. Revised §366 permits a party in interest to request that the Bankruptcy court determine the appropriate amount of adequate assurance for a utility. Accordingly, a debtor should consider filing a first-day motion to propose an adequate assurance, establishing procedures for resolving any disputes regarding the appropriate amount of adequate assurance for a utility and barring utilities from terminating service unless they have been provided with the proposed procedures; and (b) requesting a hearing on the motion as soon as possible. One possible proposal for adequate assurance would be a standby letter of credit or other collateral, equal to one or two months of utility service for all utilities, naming each utility as a beneficiary, with a draw condition on the satisfaction of certain notice provisions. The benefit of this approach to the debtor is that it is maximally invasive on the debtor’s cash-management system (unlike prepaying), does not involve a significant outflow of cash (unlike deposits) and provides a centralized system of dealing with utilities’ requests for adequate assurance.

From Pre-Filing Through Distribution. Our Experienced Team Can Immediately Handle All Of Your Bankruptcy Administration Needs.

The Garden City Group, Inc.

Unmatched Professionalism

Los Angeles, CA
San Francisco, CA
Sarasota, FL
Melville, NY
New York, NY
Columbus, OH
Portland, OR
Reston, VA
Seattle, WA

For More Information, Contact
Karen Shafer at 1.800.327.3664 or visit www.gcgorgservices.com

continued on page 76

© 1995-2009 Thomson Newspapps. All Rights Reserved. This content is protected by copyright law.

November 2005 37

ABJ Journal

The Garden City Group, Inc.

Unmatched Professionalism

Los Angeles, CA
San Francisco, CA
Sarasota, FL
Melville, NY
New York, NY
Columbus, OH
Portland, OR
Reston, VA
Seattle, WA

For More Information, Contact
Karen Shafer at 1.800.327.3664 or visit www.gcgorgservices.com

continued on page 76

© 1995-2009 Thomson Newspapps. All Rights Reserved. This content is protected by copyright law.

November 2005 37

ABJ Journal
Key Employee Retention and Severance Plans

Perhaps the most newsworthy business provisions of BAPCPA are those designed to stop perceived windfalls to executives of troubled companies. Appearances, however, can be deceiving. Although revised Code §503(c) essentially eliminates key-employee retention plans for insiders (e.g., directors and officers), it does not necessarily bar the implementation of a key-employee retention plan for noninsiders (e.g., lower key management) or performance-incentive bonuses for noninsiders and insiders alike. Similarly, although §503(c) prohibits the adoption of a severance plan for insiders alone, it does not bar the creation of a severance plan for all full-time employees of a company, including insiders, subject to certain monetary limits. Accordingly, although some might argue that revised §503(c) is a good test of whether key-employee retention plans were ever necessary, creative debtors still have the ability to develop and implement retention and incentive plans that will aid them in retaining “key employees.”

Exclusivity and the Need for Planning

Section 1121(c) of the Code provides a chapter 11 debtor the exclusive right for 120 days and 180 days, respectively, after the petition date to file a chapter 11 plan and solicit acceptances thereof. Amended §1121(d) limits extensions of those periods to dates that are 18 and 20 months, respectively, after the petition date. As noted above, this shortened timeline arguably will encourage more pre-packaged and pre-arranged chapter 11 cases. In those chapter 11 cases where a consensus is difficult or impossible to achieve, however, this shortened timeline potentially gives creditors significantly more leverage in negotiating a plan. That is, if a creditor group (e.g., unsecured noteholders) desires a different reorganization strategy, it may seek to drag out the plan process to permit the filing of a competing plan. Still, as a practical matter, only those creditors with sufficient financial wherewithal (other than official committees) will be able to fund a competing plan process. Moreover, a bankruptcy court could manage its own docket to delay consideration of a competing plan and establish procedures to level the playing field between the competing parties, thereby limiting the delay and confusion that might otherwise occur.

To combat the potential timing issues posed by revised §1121(d), a potential debtor should, pre-petition, analyze its plan alternatives on parallel tracks—trying to negotiate a pre-packaged or pre-arranged plan with its major creditor groups, while also developing a standalone plan that could be proposed early and pursued aggressively once the case is filed. Advanced planning (including a careful and realistic pre-petition analysis of a debtor’s financial and operational alternatives) may allow a debtor to maintain much of the control and leverage over the plan process that it enjoyed prior to BAPCPA.11

Conclusion

Reorganizations after BAPCPA certainly will be different than those that came before. Will they be markedly worse? Maybe, maybe not. Certain provisions of the BAPCPA (such as those discussed above) have the potential to enhance the efficiency of the chapter 11 process and thereby maximize the value ultimately distributed to stakeholders. Whether this potential will be realized, of course, remains to be seen, but with some careful planning and good advice, a chapter 11 debtor’s life under BAPCPA may not be as miserable as the naysayers have predicted.

10 In fact, revised §1121(c) of the Code appears to encourage pre-packaged and pre-arranged chapter 11 cases by permitting the pre-petition satisfaction of the acceptance of rejection of the plan to continue post-petition without the requirement of a bankruptcy court-approvied disclosure statement.

11 Unfortunately, this advanced planning may suggest no (or few) viable alternatives for a potential creditor, thereby making troubled companies face the reality of a sale or liquidation earlier in the process. Again, however, accelerating this result when it otherwise is inevitable may not be a bad thing for stakeholders (or even the company, if a going-concern sale is accomplished), as it arguably preserves value that otherwise might have been depleted in a protracted and unsuccessful chapter 11 case.

American Board of Certification
of Bankruptcy and Creditors’ Rights Attorneys

The nation's premier legal specialty certification organization, administering programs in:

- Consumer bankruptcy law
- Business bankruptcy law
- Creditors’ Rights law

You expect certification from your doctor—expect it from your lawyer, too

www.abcworld.org

JOIN THE DISCUSSION
IN THE COMMITTEE LISTSERVES

Are you participating in the ongoing discussions in the committee listserves? Don’t just “lurk”—join in.

To join in this or any other discussion, go to the ABI committee listserv item on the home page of ABI World to get started. It’s easy to do: you can sign up for new committees on the spot. Talk about the upcoming committee programs at ABI conferences, discuss the new law or debate the bankruptcy issues being played out in the courts each day.

Questions? Contact membership@abiworld.org.