

PREPACKAGED CHAPTER 11 BANKRUPTCIES –WORTH THE EXPENSE AND AGGRAVATION?



YOUR PRESENTERS



Randy Nussbaum



Sierra Minder

BIOS



Randy Nussbaum

**Bankruptcy, Loan and Real Estate
Workouts, Distressed Asset Resolution;
Certified Bankruptcy Specialist
(Arizona Board of Legal Specialization)
and a Certified Business Bankruptcy
Specialist (American Board of
Certification)**

480-212-1682 [Email](#)



Sierra Minder

**Sierra Minder practices in the areas of
bankruptcy and restructuring and
litigation.**

480-425-2626 [Email](#)

PREPACKS IN A NUTSHELL

- Bankruptcy case where when petition is filed, the Plan of Reorganization is filed concurrently, and has already been approved by the entire creditor body.
- Enforceable pre-petition agreement that binds parties to vote in favor of a Plan of Reorganization.
- Typically confirmed on expedited basis of 30-90 days.

RESTRUCTURING SUPPORT AGREEMENTS (RSA)

- Contract outside of bankruptcy that dictates how bankruptcy case will go once initiated.
- Also know as a “lock-up” agreement.
- Typically prohibits or limits creditor’s ability to trade or sell claims.
- Nonbinding on the debtor and allows the debtor to exit the RSA and propose a different.

RESTRUCTURING SUPPORT AGREEMENTS (RSA) CONT.

- Plan later, usually after the bankruptcy petition has been filed, if the RSA is not longer in the debtor's estate's best interest.
- RSA must be assumed by the Debtor and approved by the court post-petition.
- However, they are accepted by the bankruptcy court and are binding.

DISCLOSURE STATEMENTS IN PREPACKAGED CASE

- Typically, expensive and intrusive part of a Chapter 11 case.
- Must be approved by the court before any solicitations of votes can happen per Section 1125(b).
 - “acceptance or rejection of a Plan may not be solicited after the commencement of the case under this title. . . unless, at the time of or before such solicitation,

DISCLOSURE STATEMENTS IN PREPACKAGED CASE

- disclosure statement approved, after notice and a hearing, by the court as containing adequate information.”
- Prepackaged cases get around this by soliciting votes before the case is filed. If the Plan has enough votes already when it is filed, no required court approval of a disclosure statement.
- Per Section 1126(b) votes that are solicited pre-petition count as long as proper disclosures were made to the voting party prior to soliciting the vote.

CONFIRMATION OF PREPACKAGED CASE

- Court will approve the accepting votes and confirm the Plan if the pre-petition solicitation was proper.
 - Adequate disclosure required by Section 1125(a)(1).
 - Adequate notice to all creditors and equity holders required by Rule 3018(b).
 - Adequate length of voting period required by Rule 3018(b).

WHAT SITUATIONS ARE IDEAL FOR A PREPACKAGED BANKRUPTCY?

- When the treatment of the primary creditors requires impairment of other creditors for the Plan to be feasible.
- When the Plan involves many parties, global resolutions, and is susceptible to “unraveling” if any party changes its position.

WHAT SITUATIONS ARE IDEAL FOR A PREPACKAGED BANKRUPTCY? CONT.

- Typically seen in large companies with all primary parties being represented by sophisticated transactional counsel.
- The unsecured creditor body is dominated by a primary creditor.

BENEFITS TO A PREPACKAGED BANKRUPTCY

- Almost no disruption to business.
- As far as bankruptcy goes, best PR option.
- Very quick.
- Prevents minority creditors from meddling, driving costs up, and being a distraction to the reorganization.
- No disclosure statement needed.

BENEFITS TO A PREPACKAGED BANKRUPTCY CONT.

- No opportunity for opposing Plan to be filed.
- DIP financing can be used.
- Potential tax benefits.
- Preference transfers can be avoided.

BENEFITS TO A PREPACKAGED BANKRUPTCY CONT.

- Allows assets to be sold free and clear of liens.
- Do not have to file Schedules.
- Allows for non-consenting creditors to be “crammed down.”
 - Binding on rejecting creditors as long as majority of a creditor class has approved the treatment.

BENEFITS TO A PREPACKAGED BANKRUPTCY CONT.

- Majority is $\frac{1}{2}$ of class members and $\frac{2}{3}$ of total class claim amount.
- High probability of obtaining successful Chapter 11 reorganization.

RISKS OF PREPACKAGED BANKRUPTCY

- No automatic stay during negotiations.
- Possible that solicitation is found inadequate and must be repeated and disclosure statement filed.
- If unsecured creditors are not paid in full, a creditor's committee is usually appointed.

RISKS OF PREPACKAGED BANKRUPTCY

- Alerts creditors to plan to file for bankruptcy, which could lead to state court proceedings, or even an involuntary bankruptcy petition being filed, before an RSA is reached with primary or majority creditors.
- Potential issues with equity holders.
- Typical risks of filing for bankruptcy that can't be avoided.
 - Certain operational restrictions once operating as a debtor-in-possession.

RISKS OF PREPACKAGED BANKRUPTCY CONT.

- Administrative hassles – bank accounts and reporting requirements.
- Potential for trustee to be appointed or required new management.
- Negative public perception.

LEASES AND EXECUTORY CONTRACTS IN A PREPACK

- The debtor can rely on the Bankruptcy Code protections and assume or reject leases.
- This is a large benefit not available with out of court restructurings.
- Additionally, the Bankruptcy Code limits the amount of rejection damages.
- If a debtor is able to reach an agreement with its secured creditors but not its landlord, a prepackaged bankruptcy can be quick and effective.

PREPACKAGED IN SUBCHAPTER V- SMALL BUSINESS DEBTORS?

While there is nothing that precludes a small business debtor from engaging in a prepackaged bankruptcy, many of the benefits of a pre-pack are non applicable to Debtor filing under the new Subchapter V of the Bankruptcy Code.

DEFINITION OF SMALL BUSINESS DEBTOR

- A “small business debtor” can be:
 - an individual or an entity,
 - engaged in commercial or business activities,

DEFINITION OF SMALL BUSINESS DEBTOR

- whose total aggregate, non-contingent and liquidated, debts, both secured and unsecured, are not more than **\$2,725,625, which has been increased to \$7.5 million, temporarily, under the Cares Act**, and
- not less than 50% of which arose from commercial or business activities.
- Subchapter V is voluntary and optional to the debtor; only the debtor may elect to have the subchapter apply to it.

BENEFITS OF SMALL BUSINESS REORGANIZATION ACT

Among the benefits of the Small Business Reorganization Act are:

- The small business debtor remains in possession of its assets and operates its business, as a debtor-in-possession, during the pendency of the case (just as in a traditional Chapter 11).
- Only the small business debtor may file a Plan of reorganization, but it has to be filed within 90 days of the bankruptcy filing (but this deadline may be extended by the court if the need for the extension is attributable to circumstances beyond the debtor's control). There is no ability of creditors to file a competing plan of reorganization or liquidation.

BENEFITS OF SMALL BUSINESS REORGANIZATION ACT CONT.

- The Bankruptcy Court may confirm a plan of reorganization even if no class of creditors votes in favor of it and all classes reject it.
- The Court may confirm a plan over unsecured creditors' objections and allow the small business debtor's owners to retain their ownership interests, even if the unsecured creditors are not paid in full, so long as the small business debtor commits all of its "projected disposable income" for a period of three to five years to payments to creditors.

BENEFITS OF SMALL BUSINESS REORGANIZATION ACT (CONT.)

- There is no need for a small business debtor's owners to contribute "new value" in order to retain their ownership interests. This change abolishes the prior "absolute priority rule," which proved very challenging for small businesses to overcome in traditional Chapter 11 reorganizations.
- A disclosure statement is not required, so long as the Plan of reorganization provides (i) a brief history of the debtor, (ii) a liquidation analysis, and (iii) projections demonstrating the small business debtor's ability to make payments under the Plan.

BENEFITS OF SMALL BUSINESS REORGANIZATION ACT (CONT.)

- No creditors committee will be appointed, unless otherwise ordered by the Court.
- The small business debtor does not have to pay fees to the United States Trustee's Office.

These provisions will make it much easier and less expensive for small business debtors to reorganize.

SUBCHAPTER V VERSUS CHAPTER 11

- A Subchapter V is designed to be far quicker with more immediate deadlines;
- You can circumvent many of the normal steps of a Chapter 11 in a Subchapter V;
- If handled properly, a Subchapter V should be far less expensive than a Chapter 11;
- No absolute priority rule in a Subchapter V;
- Creditor consent is not needed to confirm a plan;
- No disclosure statement is needed; and
- Only the debtor can file a plan.

ALTERNATIVES TO A PREPACKAGED BANKRUPTCY

- Out of court restructuring.
- Assignment for the benefit of creditors.
- Traditional bankruptcy case.
- Prenegotiated bankruptcy case.

ALTERNATIVES – OUT OF COURT RESTRUCTURING

- Does not involve filing a bankruptcy petition.
- Usually done through credit facility amendment or an exchange offer.
- Can be limited to certain creditors.
- Good option when there is a primary creditor driving a company's insolvency.

ALTERNATIVES – OUT OF COURT RESTRUCTURING CONT.

- Requires working relationship with creditor, sometimes not possible.
- No automatic stay through restructuring practice.
- Requires unanimous consent of any creditor whose rights are impacted.

ALTERNATIVES – ASSIGNMENT FOR BENEFIT OF CREDITORS (ABC'S)

- Out of Court process.
- Type of business liquidation where all of a business's assets are assigned to third party to liquidate.
- Distribution is governed by common law and state law, which can differ from bankruptcy distribution rules.
- Requires approval of shareholders, whereas liquidating through bankruptcy does not.

ALTERNATIVES – ASSIGNMENT FOR BENEFIT OF CREDITORS (ABC'S) CONT.

- Not available in every state, state by state rules.
 - Popular in California.
- Requires secured creditor consent if assets are to be sold free and clear.
- Quicker than formal bankruptcy liquidation process.

ALTERNATIVES – TRADITIONAL BANKRUPTCY

- Bankruptcy petition filed without any agreement from creditors on Plan treatment.
- Often done when negotiations have failed and stay protection needed.
- Good option when the body of unsecured creditors and value of claims is significant.

ALTERNATIVES – TRADITIONAL BANKRUPTCY CONT.

- Sometimes necessary when there are large unknowns, such as business projections or an unknown asset value.
- Good option if there needs to be significant change in operational structure.
- Can be administratively expensive and inefficient.
- Allows opportunity for disproportionate participation of minority creditors.

ALTERNATIVES – TRADITIONAL BANKRUPTCY CONT.

- Most contested issue is valuation of assets used as collateral of secured creditors.
- Allows opportunity for disproportionate participation of minority creditors.
- Most contested issue is valuation of assets used as collateral of secured creditors.

ALTERNATIVES – PRENEGOTIATED BANKRUPTCY

- Most similar to prepackaged bankruptcy, and often a good alternative.
- Debtor and key creditors agree to the terms of the company restructure prior to filing bankruptcy petition.
- Does not have to be between all creditor classes.
- Usually involves binding agreement (RSA) between the parties, but less formality also an option.

ALTERNATIVES – PRENEGOTIATED BANKRUPTCY CONT.

- Even if not all issues worked out, valuation of collateral is often agreed on.
- If there is an RSA, Debtor moves to assume the agreement.
- After petition is filed, a plan, and disclosure statement if required, is filed shortly thereafter.

ALTERNATIVES – PRENEGOTIATED BANKRUPTCY CONT.

- Some of the same formalities (expenses) of a traditional Chapter 11
 - Unsecured Creditors could be appointed.
 - Schedules and Statement of Financial Affairs Required.
 - Hearing on the Disclosure Statement.
 - Claims Bar Date.
 - Solicitation process and ballot report.

ALTERNATIVES – INFORMAL PRENEGOTIATED BANKRUPTCY

- The fewer creditors on board and the less formality of the prenegotiated agreement, the higher risk of failure.
- Similar to prepackaged bankruptcies, not the best option if a company's debt is very diverse.
- Can be risky to negotiate plan treatment with only some creditors, when there remains unknowns that remain to be worked out through the bankruptcy process.
- Could potentially turn friendly creditors hostile if agreed upon the Plan ultimately must be modified.

WHAT HAPPENS WHEN A PREPACKAGED BANKRUPTCY FAILS?

- If the Court finds a due process issue with the prebankruptcy solicitation, it could either
 - 1) not count the ballots of the supporting creditors if there was issues with the disclosure, or
 - 2) not accept the solicitation process at all and require the debtor essentially start over.
- In either case, the Debtor is at a serious disadvantage, and any benefit from the prepackaged bankruptcy strategy will be eroded.

CONCLUSION

A true prepackaged bankruptcy is not very common, but in certain, specific instances, it can be a great option. However, for the average debtor, it may not be worth the hassle, as they will likely see similar results with a less formal pre-negotiated bankruptcy.