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2009 Bankruptcy & Corporate Restructuring
options for troubled enterprises



A new breed of bankruptcy

BY JONATHAN CARSON

A new breed of corporate bankruptcy is taking centre stage in today's global economic picture. As distressed US companies continue to seek Chapter 11 as a strategic alternative to resolve their financial and operational issues, they follow new paradigms to navigate the procedural and financial hurdles within the corporate bankruptcy process. The automakers' new twist on Chapter 11 provides one example of how the face of corporate bankruptcy is evolving as a strategic alternative. In addition, the widespread occurrence of Section 363 asset sales, prepackaged and pre-arranged bankruptcies represents renewed models of bankruptcy that companies rely upon to salvage and preserve value. Unlike previous recessions, we see that traditional, 'free-fall' restructurings have become the exception in the US, rather than the norm.

A number of driving factors contribute to the changing face of bankruptcy. Companies undergoing Chapter 11 today must contend with formidable restrictions on the process, as well as on the timeline allotted for a successful restructuring. Limited financing options, restrictions imposed by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) and the increased complexity of capital structures create the need for a more consensual, accelerated bankruptcy process. But in spite of these challenges, troubled companies continue to adapt to the steep demands of the current economic recession by extracting value from the Chapter 11 process in innovative ways.

The auto industry's Chapter 11 'hybrid'

As we look to the current restructuring cycle, the recent spate of automaker Chapter 11 filings highlight one new direction for corporate bankruptcy. The Chrysler and GM filings spawned a Chapter 11 'hybrid' with unprecedented government involvement, setting the stage for other companies that may be considered 'too large to fail'. The government's role as both the financier for the

Chapter 11 proceedings as well as the predominant stakeholder following the companies' emergence from bankruptcy played a critical role in these restructurings.

In addition, Section 363 of the US Bankruptcy Code significantly contributed to the accelerated pace of the proceedings by allowing the automakers to shed underperforming assets free and clear of liens. Indeed, the Second Circuit Court of Appeal's decision on 5 August 2009 to uphold the sale of Chrysler, despite numerous objections from its creditors, foretells the growing prevalence and acceptance of Section 363 asset sales in the course of bankruptcy. Industry analysts expect that this Second Court of Appeals decision will reinforce the ability for businesses to argue the need for expeditious asset sales to avoid a 'melting ice cube' syndrome.

So despite the challenges that remain ahead for the automakers, their Chapter 11 proceedings provide a historic example of the potential for corporate bankruptcy to create new pathways for corporate renewal. As we see other industries and companies that present potential systemic risk to the US and global economy, the automaker bankruptcies will serve as one roadmap to mitigate complex issues.

New paradigms gain prominence

Looking beyond the automakers' Chapter 11 filings, we see that the majority of today's bankruptcies rely on new paradigms as alternatives to the traditional Chapter 11 bankruptcy. Across all industries, distressed companies employ Section 363 of the US Bankruptcy Code as a more effective mechanism for selling assets than through traditional state foreclosure laws. As a result, Section 363 asset sales increasingly occurred across publicly traded Chapter 11 cases that filed so far this year, including Lyondell Chemical Company, Nortel Networks and Midway Games, among many others.

In addition, prepackaged and pre-arranged bankruptcies play a prominent role in today's restructuring environment. The recent prepackaged Chapter 11 filing of publishing giant Reader's Digest highlights this growing trend. These bankruptcies provide an accelerated course through bankruptcy by allowing the debtor to handle its negotiations with major stakeholders prior to filing the petition for Chapter 11. Indeed, according to a report issued by Standard & Poor's earlier this year, the number of pre-packaged bankruptcies reached an eight-year high in Q1 2009, and this trend is likely to continue as the rating agency predicts that the junk bond default rate will hit 14.3 percent by March 2010.

In other instances, we see other companies using Chapter 11 as a platform for M&A transactions. Printing companies Vertis and American Color Graphics successfully used Chapter 11 to merge into one entity following their respective, individual pre-packaged bankruptcies. Noted by Vertis' lawyers as the "first large (or maybe first ever) 'double-prepack-merger,'" this case shows the potential for distressed companies to use Chapter 11 bankruptcy to find original solutions to their financial and operational issues.

Navigating the evolving bankruptcy process

Today's corporate bankruptcies are more complex than ever. Many companies that undergo Chapter 11 bankruptcy on a faster timeframe find an expeditious bankruptcy to be a productive approach. However, it is important that they follow the guidance of seasoned professionals, and take the time they need in order to maximise the benefits that corporate bankruptcy has to offer.

To start with, companies navigating the 'new breed' of

bankruptcy can look to the following guiding principles to emerge successfully. Firstly, be prepared – key company information should be accessible to help expedite the process and easily locate required records. Data and other information needed during the process can include financial statements, vendor listings, employee/retiree listings, contracts, real-estate leases, etc. Secondly, be transparent – develop a strategic communications strategy to disclose forward progress to relevant constituencies during the restructuring process– from employees and vendors to financial institutions and the media. It is critical that you know what to say, when and how to say it. Finally, be sensitive – when dealing with financial matters of this scale, emotions can run rampant. Be sensitive to the needs of stakeholders and provide reassurance that their matter is one of significance and is being addressed.

While the bankruptcy game may be changing, it continues to offer a strategic alternative for companies seeking to remain profitable and competitive. Companies that approach the process strategically and expeditiously stand to gain much, despite the unique procedural and financial challenges presented by the current recession. Regardless of the exit strategy that corporate debtors use in navigating Chapter 11, distressed enterprises can continue to maximise value from the US Bankruptcy Code as it evolves to meet the needs and demands of the current economic environment.

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A former corporate-restructuring attorney, Jonathan possesses an in-depth understanding of Chapter 11 and serves as an industry expert on trends and developments within the evolving corporate restructuring arena.

He co-founded Kurtzman Carson Consultants LLC (KCC) to pursue a shared vision for fast, efficient and highly reliable client service from the perspective of professionals who understand corporate restructuring and its administrative challenges. Today, KCC is a leading claims and noticing agent that provides administrative-support services and technology solutions to the corporate restructuring industry.

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