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VIEWPOINT

One of a series of opinion columns by bankruptcy professionals

Has BAPCPA Altered The Chapter 11 Process?

By Jonathan Carson

The five-year anniversary of the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) presents an opportune time to reflect upon its impact on the Chapter 11 process. While BAPCPA clearly had a material impact on the Chapter 11 environment, macroeconomic issues over the last two years have rendered bankruptcy reform less of a focal point among practitioners and academics. In hindsight, bankruptcy reform seems a mere ripple on the corporate-restructuring ocean as compared with the tidal wave that was the financial crisis.

The combined effects of restrictions in the capital markets, plummeting consumer confidence and overleveraged corporate balance sheets made Chapter 11 more difficult to navigate over the last few years; few consider BAPCPA a primary culprit of such challenges. In fact, certain provisions have proven to be less troubling than initially feared. However, while bankruptcy reform has not holistically shifted the Chapter 11 landscape, other provisions have had a powerful impact and should be watched moving forward to ensure the corporate-restructuring process remains as fair and equitable as envisioned by its authors.

In particular, the revision of Section 365(d)(4) of the Bankruptcy Code - under which corporate debtors have less time to assume or reject real-property leases - significantly hindered efforts of large retailers during the financial crisis. These retailers fell into Chapter 11 due to the decline in consumer spending and the overall weakening of the economy. Before BAPCPA, debtors had 60 days to assume or reject a real-property lease, and such time could be extended by the bankruptcy court. These extensions provided requisite time for debtors to maximize the value of leases via traditional reorganization or by divesting these assets. With a hard cap of 210 days to assume or reject leases, debtors now often lack sufficient time to map out a strategic approach. Instead, they are forced to either conduct the lease analysis process prior to filing, which is rarely possible due to financing constraints, or conduct lease analysis prematurely. In either scenario, retailers risk the diminution of the estate's value due to an unrealistic timeframe.

Recent large retail cases - such as Linens 'n Things, Steve & Barry's and Circuit City - show that seven months is inadequate to conduct the appropriate analysis and recover value from the company's leases. Many distressed retailers have struggled with the shortened timeline as it jeopardizes two primary sources of collateral - stores leases and inventory. Accordingly, these retailers found it virtually impossible to obtain DIP financing as lenders

became reluctant to provide financing without ample time to evaluate lease obligations. Consequently, many retailers fell into liquidation scenarios rather than traditional Chapter 11 reorganizations. Some credit BAPCPA for the "death of retail reorganization" as it contributed to this increase in liquidations as well as 363 asset sales.

Notwithstanding this negative impact, BAPCPA is not solely to blame for the difficulty retailers and other industries faced in coping with the financial crisis, but it may have been the proverbial straw that broke the camel's back. Certainly, issues such as decreased consumer spending, changing consumer preferences, and overleveraged corporate balance sheets all contributed to retail challenges over the last two years. But when you combine BAPCPA with the financial crisis fallout and the tightening of capital markets, these conditions created the "perfect storm" for the retail sector, resulting in many casualties along the way. Under pre-BAPCPA laws, we may have seen more survivors.

While we have seen the negative impact of BAPCPA in the retail sector, we've also seen that certain provisions have not produced the controversy expected prior to BAPCPA's enactment. For example, changes to Section 1121 limiting the exclusivity period within which corporate debtors can propose a plan of reorganization have not presented as many obstacles as anticipated. Prior to BAPCPA, debtors were granted 120 days to file a plan of reorganization with exclusivity granted for months or years. Changes to the law capped debtors' exclusivity at 180 days after the date for the order for relief, limiting extensions to exclusivity to a maximum of 18 months. Many experts predicted that this change would pose an unrealistic timeline for large, complex corporate restructurings, particularly for companies with extensive government relations.

According to data from the UCLA-Lopucki Bankruptcy Research Database, the duration of the average large, public-company bankruptcy decreased to 483 days in 2009 from 944 days in 2008. While some argue that corporate bankruptcies became shorter due to BAPCPA's limited exclusivity period, economic trends have accelerated the bankruptcy process more than changes to the exclusivity timeframe. In the wake of the financial crisis, many lenders became more reluctant to finance traditional Chapter 11 cases and instead encouraged expeditious asset sales or balance-sheet restructurings.

Companies moved through bankruptcy at record speed over the last two years due to reasons beyond BAPCPA. Even in cases such as General Motors and Chrysler - businesses with deep government relationships and thus negotiations that take longer than

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traditional private-business situations - exclusivity never took center stage (at least not in the public's view). In those cases, the corporate debtors and their stakeholders successfully navigated Chapter 11 within an accelerated timeframe, without pushing the limits of exclusivity to reach their goals.

In conclusion, a review of the last five years reveals that BAPCPA alone has not altered the course of Chapter 11. The corporate-bankruptcy process does not occur within a vacuum; instead, it occurs within a dynamic economic landscape affected by macroeconomic trends and microeconomic challenges facing various sectors of the American economy. Despite new obstacles presented by bankruptcy reform, Chapter 11 remains efficient and effective in helping corporate debtors to navigate overleveraged balance sheets and operational challenges, and will continue to provide American businesses with a path to corporate renewal moving forward.

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