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A Changed Landscape? Bankruptcy Reform Five Years Later

by Dave Buzzell

In April of 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was enacted into law. It was commonly held at the time that the legislation would greatly change the landscape of bankruptcy filings, for consumers and businesses alike.

Now, with the five-year anniversary of the bill in the rear view mirror, it's worthwhile to consider whether the bankruptcy professional's journey these past few years has been through altered terrain and, if so, how much of that has been due to BAPCPA.

Jonathan Carson, Co-Founder and Managing Director of Kurtzman Carson Consultants, argues that the bankruptcy landscape has changed, but BAPCPA is only a small part of the reason. "The macroeconomic environment primarily impacted how we perceive the evolution of Chapter 11 cases in the last five years. While bankruptcy reform played a part in its evolution, it hasn't significantly shifted the Chapter 11 landscape."

Aaron Hammer, Chair of the Bankruptcy, Reorganization and Creditor's Rights Practice Group at Freeborn & Peters, LLP, concurs, saying that, "It's hard to evaluate BAPCPA in a vacuum given that the economic circumstances have changed so much since 2005."

Those changing circumstances include, according to Hammer, a scarcity of capital in the aftermath of the credit crisis following the collapse of Lehman Brothers; the growth of online sales, which has impacted big box retailers; a sharp decline in the value of real estate and leasehold interests, which has made retail restructurings more difficult; and a growing aversion to risk on the part of lenders. Consequently, says Hammer, a conflux of economic conditions has led to far fewer attempts to reorganize, with liquidations generally being driven by the lenders. "Cases are shorter, they are more liquidation oriented, and the most successful are prepackaged reorganizations."

Both say that through all the economic turmoil, BAPCPA has actually served relatively well. "While BAPCPA has made restructurings more complex and less likely to facilitate reorganization – although the final verdict is still out on that – it has allowed restructuring professionals to be more creative," says Hammer.

To the extent that the act has changed the lay of the land, several provisions are to blame. "A few main provisions were modified," says Carson, "and the ones the industry thought would have the most impact back in 2005 were, in fact, the ones that have had the most impact."

Section 365(d)(4)

The first of these is the lease modification provisions of Section 365(d)(4). Previously, the Bankruptcy Code required debtors to assume or reject leases within 60 days of filing, but that deadline could be extended for cause, which it routinely was, often for months and sometimes for years. Section 365(d)(4) now imposes a hard cap of 210 days. "The change was actively supported by the landlord lobby," says Carson. "They wanted some certainty, and Congress gave it to them."

As a result, says Carson, a retailer's hand is forced after seven months and with noticing

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rules, 30 days' motion, and so forth, that deadline becomes even shorter. "It's hard for companies that want to sell to find a buyer in such a short amount of time. It means that companies are going to have to spend more time in advance preparing for the bankruptcy process, including doing all their lease analyses."

As Carson sees it, when the financial crisis hit, Section 365(d)(4) compounded a difficult situation. "As companies struggled to find debtor-in-possession financing, they were hurt by not having more time to manage their leases. For most large retail Chapter 11s in the last few years – Linens 'n Things, Steve and Barry's, Circuit City – seven months was not adequate for undertaking appropriate lease analysis. It's fair to say that many retailers that ended up with liquidating in Chapter 11 would have had a better chance to reorganize had they had more time to market their leases appropriately to potential buyers."

"I don't see how a major retailer with thousands of stores can effectively reorganize within that 210-day period," adds Hammer. "This singular provision has been widely criticized as unnecessarily causing the liquidation of several big box retailers."

Nonetheless, the verdict remains out as to how much the economy is a factor, Hammer continues. "We're still in a situation where asset values are declining and online sales are growing. Perhaps some are looking to fit a round peg into a square hole in blaming 365(d)(4) for big box retailer liquidations. The reality is that a confluence of factors are responsible, with 365(d)(4) not helping, particularly for the large retailers."

Section 1121

Five years ago, the exclusivity provisions also underwent a change. Section 1121 of the Bankruptcy Code gives a debtor the exclusive right to file a plan of reorganization for 120 days after a bankruptcy petition date. In practice, this deadline was commonly extended – that is, until BAPCPA specifically set a hard deadline of 18 months.

There has been ongoing debate as to whether the new exclusivity provision has hampered reorganizations, especially for complex megadeals, but Carson doesn't think this has necessarily been

the case. "In certain restructurings involving government agencies or numerous stakeholders, then, yes, 18 months may not be an adequate amount of time to reorganize."

However, as to any evidence that the average duration of a large company bankruptcy case has decreased, Carson says the cause is mostly a result of the economic crisis, which brought about liquidity challenges and forced companies to pursue shorter bankruptcies. "The fact that companies have moved to bankruptcy in record speed the last couple years is more attributable to macroeconomic conditions within the capital markets than bankruptcy reform," Carson says.

Hammer also does not view Section 1121 as the underlying cause of shorter bankruptcies, nor has it resulted in more companies collapsing in Chapter 11. Still, he notes that successful reorganizations of large-scale corporations such as United Airlines often took years. "While restructuring professionals can understand the motivation behind the 18-month hard cap, it's unrealistic for large, complex restructurings, especially those involving government relationships."

Section 503(b)(9)

Another much-discussed part of the new Bankruptcy Code is Section 503(b)(9), which created a new type of administrative priority claim for the value of any goods received by the debtor within 20 days before the date of the filing.

Thus, in order to confirm a Chapter 11 plan of reorganization, the debtor has to pay such administrative claims in full. The problem, says Hammer, is that "as you start layering on additional significant administrative claims, reorganization becomes that much more expensive – you cannot just jam a 503(b)(9) creditor and pay him 10 cents on the dollar."

While it can significantly impact a reorganization, Hammer says that experienced corporate restructuring professionals have learned to manage vendors in such a fashion as to minimize 503(b)(9) liability by putting suppliers on prepayment COD, which ensures there is no 503(b)(9) claim. On the other hand, unsecured creditors can be disadvantaged, creating a delicate balancing act. Hammer, whose firm often represents creditors' committees, says, "We are more cognizant than ever of 503(b)(9) liability and of the fact that committee members sometimes have

significant 503(b)(9) claims in addition to their unsecured claims. This situation can create conflicts of interest among committee members."

"BAPCPA adds layers of complexity to case administration," says Carson. "It challenges corporate restructuring professionals to navigate the Chapter 11 process in new and creative ways."

Section 366

Finally, there's Section 366, which requires utilities to continue to provide service without disruption to a company that files for bankruptcy, provided that the debtor provides adequate assurance that it will pay its utility bills post petition. While Section 366 protects debtors entering bankruptcy from having utilities suspended, Hammer says that the provision effectively allows utilities to decide what constitutes adequate assurance, which is typically some form of large deposit. "That's more cash the debtor needs to navigate this one particular aspect of the reorganization," says Hammer. "Sometimes it can be significant. For example, the primary vendors to a reseller of communication services could be utilities and if they are seeking huge deposits, it might sink a case absent some creative solution."

The last five years have been eventful for bankruptcy professionals. Not long after BAPCPA was enacted, tilting the scales in the direction of creditors, the country plunged into a recession, creating a deluge of debtors.

While restructuring may get easier as the economy rebounds, both Carson and Hammer believe that Chapter 11 cases have and will continue to grow more complex every year. "You need to be more substantive in how you craft solutions," says Carson. "You have to be proactive and in front of creating these solutions, not reactive to the marketplace. This reality applies not just to law firms, but to investment bankers, financial advisors, and claims agents." □

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