

Viewpoint

One of a series of opinion columns by bankruptcy professionals

Growth In Prepackaged Bankruptcies

By John D. Penn

BankruptcyData.com recently released an analysis of corporate Chapter 11 filings and noted the increased number of prepackaged bankruptcy filings in recent years. In 2007, there were three prepackaged filings involving about \$2 billion in assets. In 2008, the number jumped to 12 with \$4 billion in assets. And from January until November 2009, there have been 30 prepackaged filings with about \$124 billion in assets being handled. And there still may be a surge left in the year's last few weeks.

A prepackaged bankruptcy is generally understood to be a bankruptcy filing where creditors' votes for and against the plan of reorganization are solicited before the case is filed. The case is then filed with the plan, and it swiftly moves toward confirmation relying on the pre-petition votes. Debtors have to prove, among other things, that the information provided to creditors about the plan meets the Bankruptcy Code's requirements for a disclosure statement (generally, that it provides adequate information for a creditor to make an informed decision regarding the plan). They also have to prove that the plan satisfies the Bankruptcy Code's other plan confirmation requirements.

Prepackaged Chapter 11 cases have a number of benefits not found in more traditional cases. Prepackaged filings usually reach their confirmation hearing much faster than cases where the plan and disclosure statement are submitted well after the case is filed. Professional fees can be significantly lower since there are usually fewer hearings and less court time is required. This generally has a smaller impact on a company's operations than the longer process in "regular" filings. These strengths are also among the weaknesses of the prepackaged bankruptcy process.

As a general rule, prepackaged cases are more likely to have a plan that converts all or part of one class of creditors into equity owners and either eliminates or significantly dilutes pre-petition equity. It is not uncommon for many creditors' claims to be unimpaired in the process since only impaired creditors vote on whether to accept or reject a plan. The fewer impaired creditors that exist, the easier to garner the required "yes" votes.

To achieve the increased speed and decreased time in Chapter 11, prepackaged cases give up a number of opportunities and rights. For example, a company that needs operational fixes in addition to changing its

balance sheet rarely finds itself in a prepackaged case. The most common operational changes - rejecting leases and contracts, selling significant assets or divisions and repositioning a company - all take more time than a typical prepackaged case contemplates.

Companies that need operational changes that are only available through a bankruptcy are usually not good candidates for prepackaged cases. These actions usually result in more claims being filed (like rejection damages claims) as a result of the process. Since it is the truly rare case that would leave rejection claims unimpaired (and paid in full), the more likely scenario is that those claims would be impaired and entitled to vote to accept or reject the plan. Securing pre-petition votes regarding claims that arise only in a bankruptcy case is not practical.

Perhaps the greatest risk facing companies pursuing prepackaged bankruptcies is that the "balance-sheet fix" of converting debt to equity does not solve the underlying problems. Those problems can become the catalyst for another bankruptcy filing in the future. It can be like using a stent to increase blood flow when the patient really needed a heart transplant. The "least invasive" procedure can provide some relief, but simply cannot remedy the more serious problems that remain.

Will prepackaged cases overtake "regular" cases to become the most common type of case? This is doubtful. Reduced professional fees and less time spent in a bankruptcy case are definitely attractive options. However, most debtors will need more help than can be provided in the typical prepackaged case. Companies that need to shrink to fit the current business climate will rarely be candidates for prepackaged bankruptcy cases.

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