

Prepacks reduce time and costs of business filings

Rhett G. Campbell / Special to The National Law Journal
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Prepackaged business bankruptcies, or "prepacks," can dramatically reduce costs and increase the likelihood of success compared to normal business reorganizations. In 2005, the average prepack required four months from filing to conclusion, compared to 20 months for a normal Chapter 11 case. According to statistics from the Administrative Office of the U.S. Courts, business-related Chapter 11 bankruptcy filings dropped to 5,345 for the year ending on Sept. 30, 2006, a sharp decline from the more than 10,000 filed in 2002. Much of this drop can likely be attributed to the increased expense, uncertainty and difficulty in seeking Chapter 11 protection due to the heightened regulatory standards found in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Recent news articles predict an increase in filings, particularly for companies with high-risk and nontraditional financing structures. There have also been a number of published articles and commentaries regarding the inefficiency and high cost of Chapter 11 reorganizations.

In instances when a manageable number of claimants can engage in substantive pre-filing negotiations, the prepackaged bankruptcy process is a quick, effective and less costly method of corporate reorganization. A prepack "is negotiated and accepted prior to the filing of a Chapter 11 case but . . . is approved and confirmed by the court in a subsequently filed Chapter 11 case." William L. Norton, 4 Norton Bankr. L. & Prac. 2d § 86:1 (2007). The essence of a prepack is that creditor solicitation and voting occur prior to filing the bankruptcy case.

Prepacks are distinct from prenegotiated or prearranged plans of reorganization. A prepack is a specific and technical process that involves the solicitation of creditor votes in advance of the bankruptcy filing. Certainty and assurance come from knowing, in advance, that the votes support confirmation of the plan. The fact of filing the prepack means that counsel is certain of the outcome. In contrast, a prenegotiated or prearranged plan can entail any number of agreements and approved actions between the parties, to be taken only after bankruptcy is formally filed. Although prenegotiated or prearranged plans can be speedy, nothing is as fast as a true prepack.

Speed is a prepack's primary benefit. Normal Chapter 11 reorganizations are often called "free falls," perhaps because there is no safety net and no certainty of outcome. Such cases typically require 12 to 36 months to conclude, even if successful. The average business bankruptcy in 2005 required 19.5 months to reach confirmation, according to the 2006 Bankruptcy Yearbook and Almanac.

Successful prepacks are often concluded in 90 days or less. All the other advantages to a prepack flow from the reduction in time that the debtor is in bankruptcy, with costs going down, control going up and external uncertainties decreasing. Thus, timing is essential. In a 1991 study of prepacks, "[t]he elapsed time from the filing of a petition to entry of the confirmation order has ranged from 42 days to 123 days in seven successful cases." Stephen H. Case & Mitchell A. Harwood, "Current Issues in Prepackaged Chapter 11 Plans of Reorganization and Using the Federal Declaratory Judgment Act for Instant Reorganizations," 1991 Ann. Surv. Am. L. 75, 79 (1992). The 2006 Bankruptcy Yearbook and Almanac (Kerry Mastroianni, ed., George Putnam III, 16th ed. 2006) states that the average prepack time from filing to confirmation in 2004 and 2005 was 114 days and 122 days, respectively. In two recent prepack cases in Corpus Christi, Texas, and Reno, Nev., the time from filing to confirmation was reduced to three days or less.

Benefits of saving time

Time, of course, is money. The high costs associated with notice requirements, procedural exactitude and public oversight found in the traditional bankruptcy process is one of the major reasons for a company to consider a prepack. By allowing the debtor to control the process and limit the involvement of peripheral committees and professionals, a prepack greatly reduces the amount of time spent in reorganization

proceedings. "Consequently, not only are the costs of administering the estate reduced, but also the deterioration of the business, which often follows a Chapter 11 filing, is minimized if not completely avoided." Case & Harwood at 75.

Public relations issues are also important during the difficult and chance-ridden Chapter 11 process. Trade creditors and investors may become reluctant to do business with a debtor mired in bankruptcy, while maintaining customer goodwill becomes more difficult if key leadership and employees leave.

Of course, there can be disadvantages to filing a prepack. The debtor gives up the benefit of the breathing spell mandated by the automatic stay, not because the stay terminates but because there is no time to take a deep breath, reflect and review options—such as which contracts to assume and which to reject. Contingent claims are also more difficult to manage and estimate in advance, and in a prepack there may not be time to go through a formal estimation proceeding. The easy way to handle contingent claims in a prepack is to leave them unimpaired. Case & Harwood at 87-88. If the reorganization plan can be confirmed without having to deal with contingent claims, then the post-confirmation period can be used to estimate, allow or disallow contingent claims. Another cost of a prepack, of course, is that of failure. If the prepack fails and resolicitation is required post-petition, then the prepack effort will be nothing more than a learning exercise.

Cases similar to prepacks, though not specifically provided for under the Bankruptcy Act, can be found as far back as 1935. In *Campbell v. Alleghany Corp.*, 75 F.2d 947 (4th Cir. 1935), a company solicited and obtained "consents" in advance of the bankruptcy filing. The debtor filed for reorganization on Nov. 28, 1934, and four days later filed a reorganization plan. By the date of the confirmation hearing, Dec. 28, 1934, more than 77% of bondholders had consented. The plan was confirmed, and that confirmation upheld on appeal, the 4th U.S. Circuit Court of Appeals saying, "There can be no question . . . but that this was a sufficient acceptance of the plan of reorganization." *Id.* at 950. The case is a good example of a prepack that worked, even to the point of affirmance on appeal.

A 1991 study found that between 1978 and 1991, only a handful of prepacks were filed and confirmed. It identified six cases in which prepacks were confirmed during that period, with time frames ranging from 42 days to 123 days. Case & Harwood at 82-84. The 2004 Bankruptcy Yearbook & Almanac found that "since 1990, prepackaged bankruptcies have become commonplace," finding that between 1986 and 2003, the highest number of prepacks on behalf of public companies was 18 in 1993, with the most recent (2003) number being six out of 142 public filings. The 2006 Bankruptcy Yearbook notes that 14 prepacks were filed in 2004 and seven in 2005.

Two recent examples

Two recent cases demonstrate the speed with which a prepack can move a company through reorganization, assuming that all the stars line up correctly. In *In re Blue Bird Body Co.*, No. 06-50026 (Bankr. D. Nev.), the prepack was filed on Jan. 26, 2006, and the plan was confirmed the next day. In the case of *In re Davis Petroleum Corp.*, No. 06-20152 (Bankr. S.D. Texas), the prepack was filed on March 7, 2006, and the plan was confirmed on March 10. In the *Blue Bird* case, the consent of a lender with a minority position in a syndicate was essential to an out-of-court workout but impossible to obtain. Only the "drag along" feature of a confirmed plan of reorganization would enable the restructuring to succeed, and a prepack was necessary to accomplish this quickly. In *Davis*, a recapitalization had to be accomplished in short order, but an objecting shareholder refused. The prepack was filed and the plan confirmed, once again "dragging along" the dissenting shareholder.

Both cases were characterized by two factors that made the shortened time frame workable. First, there had been substantial prepetition negotiations among a small number of affected parties, so that all parties (including those objecting) knew and understood the economic issues and did not require a long time to prepare for confirmation. Second, the unsecured creditors were unimpaired, i.e., legally unaffected, thus eliminating that constituency as a source of objections and mooting any issues with regard to a creditors committee, examiner or first meeting of creditors.

The biggest hurdle for the prepack proponent is complying with the applicable nonbankruptcy laws, including rules governing disclosure of the vote solicitation. Although compliance may be difficult for a public company seeking a complex restructuring, with one exception, that difficulty exists independently of the prepack requirements of the Bankruptcy Code. So while the pre-filing solicitation may seem and may actually be complex, this complexity is caused by nonbankruptcy law and not by the Bankruptcy Code, with the following exception: In a nonbankruptcy restructuring, it is possible and even likely that only record owners

of securities need be solicited and allowed to vote, which is typically provided for in the applicable indenture. In contrast, the Bankruptcy Code requires that only true owners of claims may vote. 11 U.S.C. 1126(a), (b). At least two cases have held that a pre-filing solicitation that complied with nonbankruptcy law (with a notice to record holders only) was insufficient because the Code required that beneficial owners be solicited and ultimately allowed to vote. *Pioneer Finance Corp.*, 246 B.R. 626 (Bankr. D. Nev. 2000); and *Southland Corp.*, 124 B.R. 211 (Bankr. N.D. Texas 1991).

Significantly, the rule governing prepacks does not provide any minimum period of time between the solicitation and the vote but merely says that it may not be "an unreasonably short time." What is "reasonable" varies from case to case, an attribute that adds to the flexibility of prepacks. In cases such as *Blue Bird* and *Davis*, the parties had been involved in extensive negotiations for long periods of time and understood the economic issues in play, so the period of time required between solicitation and vote could reasonably be much shorter than in a situation where claim holders have no history of the issues.

Many prepacks leave the unsecured creditors unimpaired, which may eliminate the need for a creditors committee. Also, if the class carries after an appropriate pre-filing solicitation and vote, and if confirmation shortly follows, it would seem that a committee would be unnecessary. But there are instances when a creditors committee could be necessary to implement post-confirmation plan provisions. Often, the debtor involved in a prepetition solicitation of a prepack has worked with a group of unsecured creditors as a committee. The statute provides that, if a prepetition committee was fairly chosen and is representative of the different kinds of claims to be represented, then it can be selected by the U.S. trustee to serve as an official committee.

In summary, a prepack reduces the time and cost associated with reorganization, together with the added benefits of assured success; less likelihood of business deterioration and loss of valued employees; and greater control for the debtor during the Chapter 11 process. The most obvious and best candidates for a prepack are those for which a previous out-of-court workout failed due to minority holdouts, or for which there have been substantial pre-filing negotiations among a manageable group of claimants. It is helpful if unsecured creditors are left unimpaired. However, not every case is suitable for a prepack, and the more complex the case, the more likely that a pre-filing solicitation will be inadequate. In a proper case, a prepack combines the best part of bankruptcy law-majority rule-with the relatively lower cost of an out-of-court restructuring. The result can be a win-win scenario for all.

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