FTI CONSULTING

Navigating Today's Environment

The Directors' and Officers' Guide to Restructuring

SECOND EDITION

Michael Eisenband
Consulting Editor
FTI Consulting

AMERICAN BANKRUPTCY INSTITUTE

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THE DIRECTORS' AND OFFICERS' GUIDE TO RESTRUCTURING

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9 THE NEED FOR SPEED: ACCELERATING THE CHAPTER 11 PROCESS

LEGAL PERSPECTIVE

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At some point in his or her career, nearly every executive and board member has served on a management team or board of a company facing the prospect of too much leverage, a pending financial default or major litigation exposure. When your lenders are no longer willing to amend and extend and refinancing is not an option, all companies begin to contemplate the possibility of a Chapter 11 bankruptcy filing.

Chapter 11 can be a very effective tool to implement a company's turnaround strategy or to reorganize an over-leveraged balance sheet, all while maximizing value for the company and its stakeholders. However, without effective planning and close management, the benefits available under the Bankruptcy Code may be diluted by the cost of remaining in bankruptcy longer than necessary. On top of ordinary course operating expenses, a company in bankruptcy must also pay the fees and costs of its own advisors and usually the advisors retained by lenders and official or unofficial creditors' committees. This is in addition to quarterly fees that must be paid to the U.S. Trustee. Further, while this risk can be mitigated with proper messaging, prolonged stays in Chapter 11 can cause reputational harm with both new and existing vendors and customers. In light of the aforementioned points, it should not be surprising that an expedient exit from Chapter 11 can preserve substantial value that a company's management and advisors must factor into their bankruptcy planning and strategy.

No two distressed companies have identical issues that can be resolved through a pre-set rubric. The ultimate approach implemented will depend in large part on the nature of the company's business, the complexity of its capital structure and the level of cooperation among its key stakeholders. Depending on these considerations, a company in financial distress may be able to "right the ship" without a bankruptcy filing at all and rather complete its restructuring "out-of-court." However, in many instances, a company will elect to pursue a Chapter 11 filing in order to avail itself of the tools available under the Bankruptcy Code. In general, Chapter 11 filings can be categorized as "pre-packaged," "pre-negotiated" or "free-fall" cases. Each option can bring significantly divergent

durations in bankruptcy, while at the same time carrying its own unique set of other benefits and drawbacks. This chapter briefly explores the principal considerations that any corporate decision-maker should consider in evaluating these available alternatives, with a particular focus on in-court options that provide for maximal speed and efficiency.

Overview: multiple options to implement a comprehensive restructuring

Out-of-court

As an initial matter, a company in financial distress will typically look first to an out-of-court restructuring transaction, using only those tools available at contract and under applicable non-bankruptcy law. The form of an out-of-court transaction will usually be dictated by the company's particular concerns. For example, impending funded debt maturities may, depending on the company's credit ratings and financial health, be addressed through a refinancing or maturity extension. An isolated liquidity shortfall, on the other hand, can potentially be addressed through a new money debt incurrence or equity raise, depending on the company's credit profile and prospective investor appetite. Where a company's financial issues are more complex, it may be necessary or advisable to pursue a more comprehensive solution, potentially incorporating a distressed exchange (i.e., the consensual exchange of outstanding securities for new securities, often with a lower face amount or different priority).

While each of these transactions can be consummated expediently, it may be necessary for the company to procure the affirmative consent of certain existing lenders. Obtaining these consents may be difficult, especially where the company is not in a position to offer adequate economic incentives to participants. If the amount of indebtedness held by non-participants (i.e., "holdouts") is sizable enough, a consensual transaction may not be feasible. In that case, the company may turn to other alternatives, likely through the U.S. Bankruptcy Courts, which offer a powerful method to bind holdout stakeholders through use of the Bankruptcy Code's majority voting mechanic and "cram down" provisions.

In-court

U.S. in-court processes have historically taken one of three forms. The most expedient from start to finish is the filing of pre-packaged Chapter 11 cases, which can often take approximately 30-60 days from filing to exit, although such cases can sometimes be implemented significantly more quickly. In short, pre-packaged cases entail the negotiation of a plan and the solicitation of votes thereon, each on an out-of-court basis and prior to the bankruptcy filing. After a sufficient majority of affirmative creditor votes are received, the debtor files its plan, together with its Chapter 11 petition, seeking expedited approval by the bankruptcy court and a swift exit from Chapter 11.

The second option, pre-negotiated Chapter 11 cases, entail the out-of-court negotiation of a Chapter 11 plan with key creditor constituencies, while reserving the solicitation process for the post-filing period. Only after solicitation concludes is the debtor able to seek confirmation of its plan by the bankruptcy court. In a pre-negotiated process, debtors may be able to achieve confirmation in as few as 60 days, but often 120-150 days, post filing, with the delay relative to a pre-packaged process attributable to various notice periods mandated by the Bankruptcy Code and, potentially, dissident creditor interference.

The third option, a traditional (or "free-fall") Chapter 11, entails filing for Chapter 11 protection without the benefit of significant pre-petition stakeholder support. Due to the need to negotiate a workable restructuring transaction in-court, the involvement of numerous parties in interest and various timelines imposed by the bankruptcy court, free-fall Chapter 11 cases often take much longer than either a pre-packaged or pre-negotiated path. As a result, debtors pursuing a free-fall filing often bear increased costs and heightened execution risk.

Pre-packaged Chapter 11 cases

Mechanics

Pre-packaged Chapter 11 cases, which are often the most efficient in-court alternatives from a time and cost perspective, reserve much of the heavy lifting for the pre-filing period. Specifically, in connection with implementing a pre-packaged Chapter 11 plan, the company will typically identify significant holders of its "fulcrum" funded debt instrument (i.e., the creditor class or classes who would most naturally equitize or otherwise drive negotiations) and begin discussing key economic terms of a restructuring transaction, including (i) class-specific recoveries, (ii) forms of consideration (e.g., cash, common equity, preferred equity or new indebtedness) and (iii) any new money bridge or exit financing, as necessary. Customarily, the company and these significant creditors document the terms of any agreed-upon transaction through a restructuring support agreement (an "RSA") and, later, a Chapter 11 plan. Importantly, in light of the compressed time frame and desire to achieve consensus across all stakeholder classes, trade creditors will customarily be left unimpaired — that is, they will either receive payment in full under, or otherwise remain unaffected by, the plan.

Often a pre-packaged plan is the ideal strategy to be used when there is one or more impaired accepting classes and the class voting provisions are used to drag along the holdouts in the class. A major intercreditor dispute over value and claim treatment does not typically lend itself to a quick pre-packaged process.

A pre-packaged plan process may be "dual-tracked" with an out-of-court exchange offer in order to disincentivize holdouts and ensure certainty of outcome. Mechanically, in a dual-track process the company would typically seek simultaneous creditor approval of the out-of-court exchange offer and a pre-packaged plan. If the targeted percentage of consents to the exchange are received (often 90 percent or more), the company would consummate the transaction out-of-court. If such consents are not received, but class-by-class Chapter 11 voting thresholds are otherwise met (i.e., at least two-thirds in amount and more than one-half in number), then the company would file for Chapter 11 with the goal of expediently consummating the transaction in-court. The prospect of a Chapter 11 filing and potentially lower recoveries often leads to a higher rate of consents to the out-of-court exchange, potentially addressing the holdout dilemma.

Perhaps the most enticing aspect of a pre-packaged Chapter 11 is its speed. The duration of a typical pre-packaged Chapter 11, from the filing date to confirmation of a plan, is 30-60 days. Certain debtors, however, have recently succeeded in accelerating that timeline significantly, with some confirming a Chapter 11 plan in less than 48 hours. However, these "super" pre-packaged Chapter 11 filings are generally the exception rather than the norm and are filed by debtors with relatively simple capital structures and little need to rightsize their operations, paving the way for streamlined negotiations and substantial creditor consensus.

Considerations

A pre-packaged process comes with a myriad of benefits. For one, it minimizes time spent in bankruptcy court, thereby avoiding potential operational interference and degradation of brand value, as well as certain court-mandated disclosure obligations. As to the latter consideration, and by way of example, applicable bankruptcy rules require that debtors file highly detailed schedules of assets and liabilities as well as monthly operating reports. Given the limited duration of pre-packaged Chapter 11 cases and likely unimpaired treatment of trade creditors, these requirements may be inapplicable or otherwise waived. Relatedly, with limited time under court supervision, management and the board's resources may be largely devoted to ordinary course operational initiatives and oversight, as opposed to additional bankruptcy court filings and court appearances. Meanwhile, trade creditors, who should be largely unaffected by the filing and administration of a pre-packaged Chapter 11, will very likely maintain their usual course of dealing with the debtor, thereby minimizing or eliminating operational interruptions.

With reduced disclosure obligations and less time in-court comes reduced fees and costs. This reduction becomes even more significant where a creditors' committee has not been appointed by the U.S. Trustee (often referred to as the Department of Justice's "bankruptcy watchdog"). A debtor's Chapter 11 estate is required to pay the reasonable fees and costs of any creditors' committee's professionals retained pursuant to bankruptcy court order. In pre-packaged cases where trade creditors are unimpaired and therefore deemed to accept the plan, the U.S. Trustee regularly elects to forego appointing a creditors' committee, which would otherwise result in both increased costs and a materially higher risk of plan-related litigation and inter-creditor disputes.

Pre-packaged cases do, however, come with certain drawbacks, perhaps the most crucial of which is difficulty in utilizing Chapter 11's operational restructuring tools, such as the ability to estimate contingent claims, effect free and clear asset sales and assume or reject executory contracts — the latter of which can prove to be an especially valuable tool for debtors. With limited time in bankruptcy court and an expedited march toward confirmation, debtors often have insufficient time to rightsize their operational footprint through contract rejection and amendment or piecemeal asset sales, each of which may entail protracted litigation. For this reason, pre-packaged Chapter 11 cases are generally best suited for true balance sheet restructurings that do not have a complex operational component.

Pre-negotiated Chapter 11 cases

Mechanics

A pre-negotiated process often begins in the same way as a pre-packaged process — namely, the negotiation of an RSA with the company's fulcrum debtholders. After building as much consensus as possible across creditor classes, the debtors file Chapter 11 petitions, often along with a disclosure statement embodying the deal negotiated in the RSA. Often a pre-negotiated case (as opposed to a pre-pack) is commenced for one of three reasons (or a combination thereof): (1) The debtor has run out of time to formally solicit acceptances prior to a pending event of default, (2) the debtor cannot afford to leave trade claims unimpaired (and instead is seeking to haircut such claims) or (3) the debtor requires some time to address certain operational issues, as discussed below.

Upon the commencement of the case, the debtor will move the court to approve the disclosure statement. Only after the disclosure statement is approved (typically 30 days or so into the case) is the debtor authorized to solicit votes on its Chapter 11 plan. The solicitation period of approximately 30-35 days may promptly be followed by a confirmation hearing, often within a week following the termination of the voting period. As in a pre-packaged scenario, pre-negotiated Chapter 11 cases are typically filed after the debtor has secured the support of at least one impaired accepting class, thereby streamlining the confirmation process.

Given additional time in bankruptcy court — and the attendant prospect of creditor interference and enhanced execution risk — the RSA becomes particularly important in pre-negotiated cases. An RSA typically serves to "lock up" the debtor and its supporting creditors to an agreed-upon transaction structure and expedited Chapter 11 timeline through various commonplace terms, including, among others:

- the supporting creditors' agreement to vote in favor of a corresponding Chapter 11 plan;
- the debtor's agreement to a limited no-shop, often preventing it from actively pursuing or negotiating an alternative transaction (subject to a fiduciary out);
- the supporting creditors' agreement to sell their claims only to transferees that commit to be bound by the RSA; and
- various "milestones" inuring to the benefit of the supporting creditors, which obligate the debtor to achieve certain key Chapter 11 goals by specific points in time.

Crucially, some of the foregoing terms may be used as leverage against dissident stakeholders to ensure the debtor's chosen transaction structure remains undisturbed. For instance, transfer restrictions could work to prevent aggrieved creditor groups from building their holdings in order to acquire a blocking position within a given class. Milestones, on the other hand, often result in an event of default or termination right if breached. As such, courts are often wary of entertaining extensive litigation or pushing out briefing deadlines in fear of potentially eliminating the debtor's most viable path out of bankruptcy.

Considerations

Pre-negotiated cases, which may initially serve as a backup plan in the event that a pre-packaged path fails, offer debtors a blend of efficiency and flexibility. Successful pre-negotiated cases often span only 60-90 days from filing to confirmation, although it is not uncommon for such cases to have longer durations, particularly if the plan receives significant objection from non-supporting stakeholders. In any event, this timeline keeps fees and costs under control, while also limiting potential value degradation and operational interference that may come with extended time in Chapter 11. Indeed, compared to complex or contentious free-fall Chapter 11s, which have been known to last longer than a year's time, a pre-negotiated path is notably more expedient.

At the same time, a brief stay in Chapter 11 affords the debtor breathing space to center on an optimal restructuring strategy without the threat of creditor enforcement action (by operation of the automatic stay). With a couple of months or more in Chapter 11, the debtor may conduct certain operational restructuring initiatives that a pre-packaged process may not be able to accommodate, potentially including the rejection or renegotiation of burdensome long-term contracts. In short, a company that is able to build considerable creditor consensus before it needs to file would be wise to consider a pre-negotiated path in order to preserve maximum optionality.

Free-fall Chapter 11 cases

Mechanics

It is not always feasible to garner sufficient advance creditor support to pursue a pre-packaged or pre-negotiated Chapter 11 filing. The company may simply hit a liquidity wall, preventing it from making payroll or other critical payments. Or, a company in default under its debt facilities may have to file promptly in order to stay enforcement remedies, such as sweeping cash or replacing board members (depending on what the debt documents provide). Companies facing unexpected and potentially catastrophic litigation claims may also be required to consider a free-fall filing. In such situations, even without advance creditor support, the company's board of directors and management may reasonably determine that a Chapter 11 filing is necessary to preserve the company's business.

Without advance stakeholder support for the company's restructuring strategy, additional delay in exiting bankruptcy is inherent. However, expediency should still be a driving consideration as the company navigates Chapter 11. In fact, expediency is built into the Bankruptcy Code and may be required by the bankruptcy court. For example, in any Chapter 11 case, the debtor has the exclusive right to file a Chapter 11 plan for 120 days after the petition date. This effectively keeps the debtor in control of negotiations because it precludes the filing and solicitation of competing plans. This period can be extended up to 18 months after the petition date. However, after some period of time without progress toward a consensual restructuring, both stakeholders and the bankruptcy court may refuse to condone further extensions, requiring the debtor to proceed toward confirmation of a plan, at risk of otherwise losing control of its restructuring efforts. Further, any order authorizing the debtor to use cash collateral or to borrow debtor-in-possession ("DIP") financing typically sets milestones (such as a deadline to complete a sale or to file and confirm a plan) that if tripped can have dire consequences for the company. As a result, a debtor does not have an unlimited amount of time to negotiate and implement its path to exit.

In a free-fall bankruptcy, the ultimate goal for the debtor should be no different than in a pre-packaged or pre-negotiated Chapter 11 case — to obtain sufficient creditor support to confirm a Chapter 11 plan. Even if all classes of creditors are not immediately in agreement with the debtor's first Chapter 11 plan proposal, obtaining sufficient stakeholder support to cram down a plan on dissident stakeholders (including the support of an impaired accepting class) can help drive negotiations to consensus. The path toward exit is often iterative, and a lack of unanimous creditor support for the debtor's first plan proposal should not hinder its restructuring efforts.

Considerations

Free-fall Chapter 11 filings can take any size or shape. However, there are at least three common themes that management should consider if a free-fall filing becomes necessary or advisable.

First, it is critical to develop a realistic timeline for the company to emerge from bankruptcy. This will be in part influenced by the debtor's plan exclusivity period or case milestones. But more importantly, this will be driven by the debtor's liquidity position. If the debtor is projecting that it will run out of cash in a certain month following the petition date, and it is unable to borrow additional money, then the debtor's restructuring plan must account for this timeline.

Second, the debtor's management and advisors should immediately identify stakeholder groups who may sign on to the debtor's restructuring efforts and whose support can drive confirmation of a plan over the objection of dissident creditors. This is critical to implementing a restructuring strategy that minimizes time in bankruptcy.

Third, the debtor should pick its battles. In many Chapter 11 cases, some level of litigation regarding the debtor's or creditors' rights is necessary before the debtor can ultimately confirm a Chapter 11 plan. However, in assessing litigation strategy, the debtor must always be cognizant not only of cost, but also of how that strategy fits into its broader restructuring plan.

Conclusion

A company's restructuring efforts are subject to a wide variety of influences, some of which may be out of the company's control. However, with limited (if any) exceptions, there is one universal truth: If a company requires the assistance of the bankruptcy courts to reorganize, a shorter stay in bankruptcy will preserve value and put the company in a better position upon emergence. Developing an early exit strategy is critical, as is flexibility if unforeseen hurdles occur. And, of course, careful and diligent management of the bankruptcy case and creditor relations is equally important to ensure that strategy remains on track. With the assistance of experienced advisors, a company may develop an optimal Chapter 11 strategy designed to both minimize time in bankruptcy and ensure that management is able to achieve its goals.

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