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# TAKING BANKRUPTCIES TOO FAST AROUND THE CURVE

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Faster isn't necessarily better–at least that's what one recent report posits.

A Fordham University study authored by Shearman & Sterling LLP's Fay Teloni highlights how the Bankruptcy Abuse Prevention and Consumer Protection Act has affected the Chapter 11 landscape, most notably by creating more of them.

In the study, last revised on Aug. 24, Teloni wrote that due to the 2005 bankruptcy law, the length of cases has dropped to 261 days from 480. (She examined 277 cases pre-BAPCPA and 113 cases post-BAPCPA to determine the number of days, which represent a mean.) That said, she also pointed out that the cases that have had to file for bankruptcy protection a second or a third time have risen by 30% since 2005.

In the 26-page study, Teloni, wrote, "While shorter Chapter 11s, and preplanned cases entail lower costs for the debtor, they have been linked with higher refiling rates. Therefore, and as anticipated as a consequence of the less time spent in bankruptcy and the increased proportion of pre-planned cases, BAPCPA is also positively associated at a statistically significant level with refiling rates, a finding that suggests that the 2005 amendments force the debtor to ignore operational problems and hastily attempt to emerge from its Chapter 11 proceedings." (Under BAPCPA, the debtor's 120-day exclusive period to file a plan can't be extended beyond 18 months and acceptance of the plan ends at the 20-month mark.)

As The Deal worked to complete its third quarter Bankruptcy League Tables, many restructuring professionals said that cases are indeed moving faster-though that's not necessarily just due to BAPCPA.

Experts said that, because of the state of the choppy credit market, quick sales where there is nothing left for a company to administer and pressure from secured lenders are all contributing to Chapter 11s that seem to be moving at lightning speed.

Due to that quick pace, then, are certain key issues getting ignored?

Joseph R. Sgroi at Honigman Miller Schwartz and Cohn LLP (14 active cases in the third quarter of 2015, placing the firm 54th by number among law firms in the Deal's Bankruptcy League Tables) said, "What you're seeing more often is reorganization cases where companies are not doing as good of a job addressing operational issues because of the need to exit in the time frame."

These types of issues can include right sizing a workforce, adjusting a company's domestic or global footprint, reducing lease locations for a retailer, for example, or the number of facilities for a manufacturer, Sgroi said.

Sgroi did point out that due to BAPCPA, "a lot of pre-bankruptcy planning ends up being necessary. The need to exit faster has required there to be a lot of pre-bankruptcy planning and negotiation."

Mark Fink, partner at Montgomery, McCracken, Walker & Rhoads LLP, said the state of the market also has a lot to do with why prenegotiated and prepackaged plans are in favor-something Teloni highlighted in her report.

"I think the credit markets have a large impact on prenegotiated plans or plans that are proposed very quickly," he said. A company may opt to take a deal quickly when all of its major creditors support it rather than wait to see what may transpire in the case, just to address operational concerns.

"You may make take the bird in hand and go with the deal you have," Fink said.

William W. Kannel, a member in Mintz, Levin, Cohn, Ferris, Glovsky and Popeo PC's bankruptcy department (16 active cases in the third quarter, placing it 52nd by number among all law firms) said, "Not so long ago, bankruptcies used to have a beginning, middle and an end."

In the beginning period, some scaffolding that let you run the case was put in place with first-day requests such as debtor-in-possession financing, cash collateral, prepetition wages were addressed, he said. The "middle period, was not really legally intensive, that was where the business people actually tried to fix the business." And at the end, he noted, is when "having fixed the business, you determined what amount of debt you needed to restructure."

Now, Kannel said, many debtors enter bankruptcy with a plan support agreement, a restructuring support agreement or a sale motion that often tries to dictate the course of the case from the beginning.

"The old-line classic, beginning, middle and end cases are not as common anymore," he said.

One of the reasons why, Kannel noted, is because the Bankruptcy Code is more geared to 1970s manufacturing companies and retail chains that had straightforward capital structures and not the wider variety of debtors with increasingly complex debt structures that we have today.

He continued, "Second, there is a very savvy class of distressed debt investors now-with a very liquid distresse debt market, much more than it used to be."

Additionally, Sgroi said, the shorter window of opportunity may have contributed to forced liquidations for some companies. "Because you can't really stay in bankruptcy for an extended [amount of time], a company isn't addressing fundamental, structural and operational issues, which has caused some cases to turn from a reorganization to a sale."

SierraConstellation Partners LLC's Larry Perkins (2 active cases) said, "the reality of it is, when you have a three to six-month horizon as opposed to a six-to 12 month one, the number of arrows in your operational quiver are very limited."

Perkins said as a result, debtor are forced to employ "really quick cuts that will have a big impact," such as contract rejection, as opposed to a fundamental operational change.

Martin A. Sosland, partner at Weil, Gotshal & Manges LLP (47 active cases in the third quarter, placing it 25th by number among all law firms), said there is certainly some truth to some companies failing to address operational issues while in Chapter 11 while only dealing with financial problems.

"Simply fixing the balance sheet won't fix the business," he said. "By not taking the time to address the structural and operational issues, then you can end up with a subsequent filing."

That said, Sosland noted that BAPCPA may not be the only reason or even the main reason-and he cautioned against over-generalization.

"The reasons for restructurings can be so individualized," Sosland said. "Overall, it's probably true that quicker Chapter 11s can lead to more Chapter 22s, but why it happens? You'll have to look at it on a case-by-case basis."

Companies in industries that have been disrupted by technology are particularly vulnerable-just look at what has happened to book stores, video rental stores and just about every teen retailer.

"You can have a fix that you think is going to work, and something comes along and you're back in bankruptcy," Sosland said.

Perkins said that BAPCPA has certainly made Chapter 11 more efficient, adding that the administrative costs of cases "have gone down immensely" because they are not dragging on as long.

That said, there are definitely downsides to a ticking timeline.

Fink said, "I think it's caused people to become more aggressive in their positions earlier in the case. I don't know that it's necessarily fostered as much negotiation and open communication as it could have. People have become more entrenched in their positions as opposed to being more willing to reach a compromise."

And just because BAPCPA has put the kibosh on long exclusivity periods, that doesn't mean that things will automatically become easier to resolve.

"When you're in a large complex case, just because you run out of exclusivity doesn't mean that anybody else is going to propose a plan, or be in a position to propose a plan," Sosland said.

William P. Weintraub, partner at Goodwin Procter LLP (11 active cases in the third quarter, placing it 57th by number among all law firms), said "I take with a grain of salt what's said here [in the study]," due to its reliance on anecdotal evidence, other articles and the LoPucki Bankruptcy Research Database.

"That said, I don't think the study is wrong in the sense that cases are shorter and that reorganizations are more financially oriented than operationally oriented," he said.

Weintraub continued, "[The study] doesn't address a couple of fundamental questions."

He said that there "has been a sea change" in the way debt is structured now, as compared to when BAPCPA was enacted. "Capital structures are more complicated now...so I think now there is an impetus to do cases as prepackaged and prenegotiated, as a result of those more complicated capital structures."

He said that those structures began to become more complicated around the time BAPCPA was enacted, adding "I also think that the prepackaged tool came into vogue around the same time, too. The company or its creditors want to grab control of the case before it files for Chapter 11."

He said "there may be other factors at work here than just BAPCPA."

Perkins noted that due to the quicker pace of reorganizations, debtors have to be looking ahead even before their petition is filed.

"You have to know how you're getting out of bankruptcy when you filed," he said. "It's become a time to execute a plan as opposed to come up with one."

He added, "Frankly, we will see a lot more [Chapter 22s on the horizon]."

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