



## **Look Out for A Bankruptcy Rush Tougher rules could accelerate corporate filings this fall**

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Be prepared for an increase in corporate bankruptcies this September, as many companies may opt to unfurl the protective Chapter 11 umbrella while it can still keep them dry. Starting Oct. 17, U.S. bankruptcy law will become decidedly more creditor-friendly. So for companies considering restructuring, there could be an increased sense of urgency attached to their decision to file.

"It's a creditor-friendly bill," said Larry Adelman, principal at restructuring firm **AEG Partners**, referring to the Bankruptcy Abuse Prevention and Consumer Protection Act. "And naturally, there was no one to lobby" for the borrowers, he said.

In a move that may foreshadow the actions of corporate borrowers, consumers are now swarming bankruptcy courts. Indeed, total consumer filings for this year's first quarter were the third-highest first quarter, ever. But whether corporate bankruptcies will follow depends, said Adelman, on "how many people have actually figured out the bill."

To be sure, there are several changes to the bankruptcy code that will make the process more onerous. For starters, companies will need a lot more cash to enter into a bankruptcy than at present. Right now, for example, utilities cannot discontinue service as a result of a bankruptcy filing. But under the new act, the filing company must post a cash deposit or equivalent in order to continue their service. Vendors will also have priority over bondholder and equity claims with regards to merchandise distributed to the debtor within 20 days prior to the bankruptcy filing. Both of these provisions will make for a heavy cash drain, especially for companies with liquidity constraints.

The act also limits the debtor's exclusivity period, which is the real boon of filing for bankruptcy. Current law allows for indefinite extensions, which serves to drag out the time before bondholders and other creditors see recovery. But beginning this fall, that period will be capped at 18 months, with no room for extension. For large corporations with complicated bankruptcies, such a quick turnaround may not be possible, and if a cohesive plan is not filed at the end of 18 months, the company must put itself at the mercy of creditors and other interested parties.

"Exclusivity gives the debtor real clout," said Steve Katz, legal counsel to Babson Capital Management. "[The new law] cuts off the unlimited right to drag things out." Two and a half years after filing, UAL Corp., for example, may be one of the companies that, as Katz put it, has "become comfortable" in bankruptcy status.

According to Adelman, another key factor for companies considering reorganization will be the extent to which their advisers push them. After the Labor Day parties end, many companies, particularly those that would eventually end up filing anyway, are going to file, perhaps prematurely, in order to avoid the restrictions of the new law. "Whether it will be a rush to the bar or just 5% more, I don't know," he said.

It remains to be seen which industries will be most affected in the near term. Due to the harsher laws governing leases, retailers have major reason for concern. Under the new act, retailers will have only seven months to decide whether to assume or reject a lease (120 days, plus one 90-day extension without landlord approval). The current law allows a judge to extend this time frame indefinitely. This change will be of particular concern to large retailers that have hundreds of stores to assess.

Of concern to executives is a section of the new code that curtails the ability of bankrupt companies to pay bonuses to retain critical managers. With the knowledge that it will be much more difficult to obtain incentive compensation to stay on during the restructuring process, executives with companies on the brink of bankruptcy may push for a filing before the new law takes effect.

Still, the economy is relatively healthy, so investors shouldn't expect a massive filing frenzy, said Kingman Penniman, CEO of KDP Investment Advisors. "The expectation among a lot of high-yield players is that there may be cause for concern, but that will become more apparent in the second half of 2006 and into 2007, as opposed to fall 2005," Penniman said.

Penniman also said that the act might encourage more prepackaged bankruptcies. And on the bright side, at least for investors, "recovery values should be higher because of how much cash companies will need going into a bankruptcy."