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BAPCPA Will Bring Major Changes

Shift Expected in Debtor/Creditor Dynamic

By Julie Schaeffer

Most early coverage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) focused on the new law’s consumer provisions, but there are significant changes in store for businesses as well. Some would even say that bankruptcy professionals have been blindsided by the extent of the changes. Some highlights follow.

Under the old Bankruptcy Code, a debtor generally had a 120-day exclusivity period to file a plan and solicit support. A bankruptcy court could extend the exclusivity period on a showing of good cause, and there was no limit on the extent. “In large cases, the courts would grant extensions that would go into years,” says Stephanie Wickouski, co-chair of the corporate restructuring group at Gardner Carton & Douglas LLP. BAPCPA imposes a new deadline for the exclusivity period: an absolute limit of 18 months from the date of the order for relief.

According to Craig Dean, a principal with AEG Partners, in smaller bankruptcies, the shorter deadline may simply help reinforce the idea that “debtors should get on with plan and not let it languish.” But in more complicated bankruptcies, both Dean and Wickouski agree that it’s just not possible to build consensus in 18 months because there are too many operational changes that need to be made before the company is ready to propose a plan. And, when the exclusivity period ends, any interested and powerful constituents, such as lenders, bondholders, pension funds, and unions, will submit competing plans for the scrutiny and approval of the court.

The result: “The new code is going to dramatically change the dynamic of the debtor/creditor negotiation process by giving more leverage to creditors’ committees,” stated Wickouski.

Under the old Bankruptcy Code, debtors had what Dean calls “a powerful debtor tool” – 60 days to assume or reject leases (of property, equipment, etc.) until confirmation of the debtor’s plan, and that time frame was routinely extended by the bankruptcy court. Under BAPCPA, leases must be assumed or rejected within 120 days. Only two 90-day extensions are permitted (and the second only if the lessor of the property agrees).

Dean says this change may not affect smaller bankruptcies. But in more complicated cases (particularly for retailers, who might have 500 or so stores), it could be “a big deal,” because “there may not be a viable restructuring plan put forth [by the time the company has to make a decision about leases] and knows what it makes sense to assume or reject.”

As a result, says Wickouski, “The new law will curtail the marketing period for selling off leases. There will be a shift in power to commercial landlords, and that is going to affect the value that can be realized by debtors.”

Another significant change that will affect commercial enterprises relates to stay bonuses for key employees. Traditionally, key employee retention plans paid such bonuses to critical managers. But under BAPCPA, the bankruptcy court can only approve a stay bonus if an employee meets the critical test as a key manager and also has a “bona fide job offer from another business at the same or a greater rate of compensation.”

The problem, according to Dean, is that if an employee is that far down the road with another company, the bankrupt company is going to lose him. “So the new law, in effect, eliminates key employee retention plans.”

Added Wickouski, “I think that may make it difficult to retain and recruit senior management in large companies that file for bankruptcy protection.” She noted that stay bonuses had been granted in almost every large case – so often, in fact, that “the pendulum has swung and the appetite for that has diminished.”

Dean and Wickouski both acknowledge that the change is a reaction to what has been seen as excessive executive compensation. And Dean says the change to no stay bonuses probably makes as little sense as routinely paying stay bonuses, and that it is unlikely that many people will complain. “Creditors probably aren’t shedding any tears because they don’t want to pay stay bonuses to the people who got the company into problems in the first place. It probably has no effect on debtors, because bringing in professionals to fill those slots is just as expensive as paying the stay bonuses. Moreover, the change is good for people who do restructuring work, because a company will be more vulnerable to departures [and thus require interim management].”

Some potentially very expensive changes effected by BAPCPA are the provisions pertaining to administrative expense priority and utility expenses. Richard B. Levin, a partner with west coast restructuring practice of Skadden, Arps, Slate, Meagher & Flom LLP, explained that under BAPCPA, administrative expense priority will be extended to suppliers who ship goods to debtors within 20 days prior to the bankruptcy. “This is going to be very expensive.”

With respect to utilities, under the old law, explained Levin, utilities could not refuse to discontinue service based on a bankruptcy filing as long as they had received “adequate assurance” of future payment – which consisted of a good payment history, adequate cash flow, a sound business plan, etc. Under BAPCPA, the debtor must post either a cash deposit or cash equivalent (such as a surety bond or letter of credit) to maintain utility service. “This is going to be a big cash drain on companies with a lot of locations entering bankruptcy,” stated Levin.

While Dean applauds many of the creditor protections BAPCPA offers, Levin thinks it is unfairly biased against debtors. “If you look at any other kind of bill, people on both sides appear before Congress, pulling in opposite directions, saying ‘Do it my way.’ A good example is the asbestos legislation going through the Senate Judiciary Committee right now: You’ve got the producers and the insurance companies and labor unions and plaintiffs’ lawyers, and they’re all in there protecting their own interests,” he explained. “But with bankruptcy legislation, there is only one side. Companies don’t show up in Congress saying, ‘I may someday be bankrupt and want to protect myself.’ The only folks who show up are creditors saying, ‘I’ve been treated unfairly in bankruptcies and I want protection.’ So this bill is a Christmas tree of increased protection for creditors that showed up and asked for something.”

The result, Levin says, will likely be bad for businesses. “Bankruptcy is a zero-sum game: If certain groups get more, others get less, including the debtor who needs money to restructure.

It's likely that this law, by protecting certain groups over others, will make it difficult for companies to reorganize. That will cause job losses and the decline of communities in which the businesses fail. So it's not a bill that is good for businesses overall."

As for Wickouski, she believes that BAPCPA will likely change the dynamic in complex bankruptcies enough that companies who are now experiencing significant problems may try to file before the law takes effect on October 17. "I think there is going to be a rash of filings," she says.

But Dean and Levin disagree. Chapter 11 is an expensive tool, so companies won't use it unless it is the best or only option, they say. "I think you'll see an increase in filings, but only a little blip," predicts Dean. And that blip, says Levin, will result in "a small increase in August, September, and early October, then a drop in late October and early November."

In the meantime, Levin announced the forthcoming publication of the *Interlined 2005 Amendments to the Bankruptcy Code and Related Laws as enacted by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, prepared by Skadden, Arps, Slate, Meagher & Flom LLP. The book will be published by Beard Books.