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Building Blocks

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Prepackaged Bankruptcy: Is It Right for Your Company?

It is no secret that a chapter 11 case can be lengthy and expensive — potentially lasting years and costing millions of dollars in fees and expenses. To this end, a prepackaged bankruptcy (also called a “prepack”), in which a debtor negotiates the terms of a chapter 11 plan and solicits votes prior to the bankruptcy filing, can provide a favorable structure to minimize a debtor’s time in chapter 11, reduce costs and operational disruptions, preserve estate value, and still secure the benefits of a chapter 11 plan. This article focuses on the use of prepacks generally, first outlining their statutory basis, then summarizing their benefits, and finally exploring a recent successful use of the prepack structure in the bankruptcy case of *Genco Shipping and Trading Ltd.*¹



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Statutory Framework, Guidelines and Practical Considerations

There are primarily two Bankruptcy Code sections that provide the statutory basis for a prepack.² Section 1125(g) provides that votes on a plan may be solicited before the commencement of a bankruptcy case if the solicitation complies with applicable nonbankruptcy law (such as the securities laws).³ In turn, § 1126(b) permits a debtor, in computing class acceptance under a plan, to use a vote that was solicited before the filing of the bankruptcy petition, so long as the vote was solicited in accordance with applicable nonbankruptcy law or, in the absence of applicable nonbankruptcy law, after disclosure of “adequate information.”⁴ Fed.

R. Bankr. P. 3018(b) expands on this statutory framework to require that the solicited plan be transmitted to substantially all holders in a class, and the solicitation period not be “unreasonably short.”

In addition, a number of bankruptcy courts have adopted guidelines, general orders and/or local rules that clarify aspects of prepack procedure not specified in the Code and Rules, thereby promoting procedural predictability and judicial economy.⁵ For example, the U.S. Bankruptcy Court for the Southern District of New York (SDNY) adopted the Procedural Guidelines for Prepackaged Chapter 11 Cases (as amended, the “SDNY Guidelines”).⁶ Among other things, the SDNY Guidelines clarify the length of a reasonable solicitation period under Fed. R. Bankr. P. 3018(b), specifying that “[u]nder ordinary circumstances,” a solicitation period of 21 days for the majority of claims, including publicly listed securities, and 14 days for unlisted securities would not be “unreasonably short.”⁷

Taken together, the statutory framework and practical realities of a prepack lend themselves to financial — not operational — restructurings. To solicit votes on a plan, a debtor needs to know what creditors are entitled to vote and the amount of their respective claims. In a traditional bankruptcy, the bankruptcy court sets a bar date by which creditors must assert all pre-petition claims against the debtor.⁸ This process allows the debtor to conclusively define

1 Case No. 14-11108 (SHL) (Bankr. S.D.N.Y.). The authors and other members of their firm, along with Blackstone Advisory Partners LP, represented Genco and certain of its affiliates in their chapter 11 cases.

2 See also 11 U.S.C. § 1125(g) (permitting pre-petition solicitation to continue after bankruptcy filing).

3 Pursuant to the Securities Act of 1933, the solicitation of a prepackaged plan in which securities will be issued is deemed an offer to acquire the securities. Such an offer must be registered with the Securities and Exchange Commission unless an exemption from the registration requirements is available. The most common exemptions are section 4(a)(2) of the Securities Act and Rule 506 of Regulation D under the Securities Act for private placements, as well as section 3(a)(9) for issuer exchange offers, in each case subject to various conditions.

4 “Adequate information” is defined in § 1125(a) of the Bankruptcy Code and generally includes information that would enable a hypothetical investor to make an informed judgment regarding a plan.

5 See, e.g., the SDNY Guidelines (as defined herein); Local Bankruptcy Rules for the Southern District of California, Appendix D4 (Guidelines for Prepackaged Chapter 11 Cases); Southern District of Indiana Bankruptcy Court General Order No. 03-11 (Procedures for Prepackaged Chapter 11 Cases) (the “Indiana Prepack Procedures”); and Bankruptcy Court for Southern District of Florida Guidelines for Prepackaged Chapter 11 Cases.

6 Although advisory, the SDNY Guidelines are incorporated by SDNY Local Bankruptcy Rule 3018-2. SDNY Guidelines, Section I.

7 SDNY Guidelines, Section XI; see also Indiana Prepack Procedures 3.4 (providing that “[u]nder ordinary circumstances,” a solicitation period of 20 days for the majority of claims, including publicly listed securities, and 10 days for unlisted securities, would satisfy Fed. R. Bankr. P. 3018(b)).

8 Fed. R. Bankr. P. 3003; SDNY Local Bankruptcy Rule 3003-3.

the range of creditors and claims to solicit votes on a plan. However, a debtor cannot establish a bar date to identify and solicit its creditors prebankruptcy. Thus, in the prepack context, a debtor can generally only identify and solicit financial creditors (such as lenders and bondholders) with readily ascertainable claims.

The identity and claim amounts of other creditors (such as trade and litigation creditors) are more difficult to establish reliably without the benefit of a bar date, making pre-petition solicitation of such claims, and compliance with Fed. R. Bankr. P. 3018(b), impractical in most cases. As a result, in a prepack chapter 11 plan, the claims of nonfinancial creditors are frequently classified separately from those of financial creditors, and left either unimpaired (*i.e.*, reinstated or paid in full) or totally impaired (*i.e.*, receives no distribution), avoiding the need to solicit votes from such creditors.⁹

Benefits of a Prepack

Chapter 11 is often expensive. The Code and Rules require a debtor to make extensive disclosures to its creditors and obtain court approval before taking actions that are outside of the ordinary course of business, such as obtaining financing, using cash collateral, paying professionals, selling assets and settling claims. Obtaining approval for these types of actions can be lengthy and costly, requiring motion practice, notice, hearings, objections and issuance of a decision on a contested motion. In addition, a debtor must pay the fees of not only its professionals (such as lawyers and financial advisors), but also the professionals engaged by any statutory appointed committee. There are also significant costs associated with the preparation, distribution and approval of a chapter 11 disclosure statement and plan.

In a prepack, however, much of the work required to document the restructuring (including the drafting and solicitation of a chapter 11 plan) is completed before the bankruptcy filing so that, as of the filing, the primary unresolved issue is confirmation of the chapter 11 plan. By minimizing a debtor's time in bankruptcy, a prepack limits the administrative costs that a debtor would otherwise incur during the bankruptcy case.

To this end, the SDNY Guidelines were drafted to facilitate an expeditious bankruptcy. Among other things, the SDNY Guidelines provide that the disclosure statement and confirmation hearings should be combined "whenever practicable,"¹⁰ which eliminates the need to have (and prepare for) two hearings, the requisite notice period for each (28 days)¹¹ and the accompanying cost. The SDNY Guidelines also permit the waiver of the requirements to (1) file schedules and statements of financial affairs and (2) hold a meeting of creditors pursuant to § 341 of the Bankruptcy Code¹² — all of which saves the debtor time and money.

An analysis of the largest prepacks in the SDNY from 2012-14 shows that prepacks are relatively quick proceedings. As demonstrated by the table, prepacks in the SDNY can be confirmed as soon as 30 days from the bankruptcy filing and generally do not take longer than approximately 80 days to complete (with many finishing much sooner).

Furthermore, the debtor can often avoid the appointment of a statutory committee when utilizing the prepack structure, leading to a significant cost savings to the estate. Out of the 12 cases cited in the table, only two had a statutory committee: *Sbarro* had a creditors' committee, while *Genco* had an equity committee. Where, as is common in prepacks, all unsecured creditors are either unimpaired or have otherwise voted in favor of the plan (each case cited in the table other than *Sbarro* and *American Roads*), an unsecured creditors' committee is not necessary.¹³ Indeed, the SDNY Guidelines contemplate that a creditors' committee should not typically be appointed in a prepack "where the unsecured creditors are unimpaired."¹⁴ In addition, an equity committee will not be appointed in cases where equityholders are clearly out of the money (each case cited in the table other than *Genco*).¹⁵

The prepack structure also helps preserve vendor and customer confidence and employee morale. Since a chapter 11 plan is negotiated before a bankruptcy filing, the debtor can better provide these constituents with clarity on how they will be treated in the restructuring, thereby obtaining their cooperation and support upon the filing.¹⁶ Also, the accelerated bankruptcy timeline greatly simplifies vendor and creditor communications concerning the bankruptcy.

Finally, negotiating a plan prior to the bankruptcy filing limits an adverse party's ability to use the bankruptcy process as leverage in its negotiations with the debtor. Specifically, once in bankruptcy, an adverse party can cause dislocation for the debtor through motion practice (including motions to appoint an examiner, lift the automatic stay and/or terminate exclusivity), whereas outside of bankruptcy, an adverse party's ability to cause disruption for the debtor while negotiating the terms of the plan is more limited.

Case Study: Genco

One recent example of a successful prepack is the bankruptcy case of *Genco*, an international drybulk shipping company. Before its restructuring, *Genco* was significantly overleveraged, with approximately \$120 million of cash and approximately \$1.4 billion in secured and unsecured debt. Starting in 2014, *Genco* faced approximately \$221 million in annual



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9 See 11 U.S.C. § 1126.

10 SDNY Guidelines XI; see also Indiana Prepack Procedures 3.8.

11 Fed. R. Bankr. P. 2002(b).

12 SDNY Guidelines, Sections VI(C) and VIII. See also 11 U.S.C. § 341.

13 In *American Roads*, the U.S. Trustee attempted to form a creditors' committee by contacting the 30 largest unsecured creditors but was unsuccessful. See Notice of Inability to Appoint Committee, *In re American Roads LLC, et al.*, Case No. 13-12412 (BRL) (Bankr. S.D.N.Y.), ECF No. 73.

14 SDNY Guidelines, Section VIII(C).

15 See *In re Ampex Corp.*, Case No. 08-11094, 2008 Bankr. LEXIS 1536, *2-3 (Bankr. S.D.N.Y. May 14, 2008) (stating that equity committee is unwarranted when debtor is "hopelessly" insolvent).

16 The SDNY Guidelines note that typical first-day relief in a prepack may include the authorization to pay creditors whose pre-petition claims would otherwise be paid in full in cash on consummation under the debtor's plan. SDNY Guidelines, Section VI(C)(16).

amortization payments, with \$55 million in amortization payments coming due in the first quarter of 2014.¹⁷ Simply put, Genco had too much debt and not enough cash.

As a global shipping company, many of Genco's customers and vendors were also unfamiliar with American restructuring practice and prone to seeing bankruptcy as being synonymous with liquidation. In these circumstances, anything other than a brief, predictable stay in chapter 11 threatened to seriously undermine Genco's relationships with these parties. In addition, Genco's principal assets — its ships — were located all over the world. If international creditors sought to arrest vessels in remote countries with unpredictable legal systems, Genco's business could have been severely impaired. While it could attempt to enforce the automatic stay internationally, that would have imposed significant costs and delays, and would have been highly uncertain in outcome.

In early 2014, Genco began negotiating a restructuring with its financial creditors.¹⁸ On April 3, 2014, Genco executed a restructuring supporting agreement (RSA) with its financial creditors for a prepack reorganization plan, which would provide for the conversion of \$1.2 billion of Genco's debt into equity of the reorganized Genco, a \$100 million equity rights offering and unimpairment of general unsecured claims. In addition, although Genco's common stock was out of the money, its board negotiated a distribution for its common stockholders in the form of seven-year warrants for 6 percent of the equity of the reorganized Genco.

On April 16, 2014, Genco commenced the solicitation process for its prepack plan. Thereafter, on April 21, 2014, Genco and certain of its subsidiaries filed for chapter 11. On April 23, 2014, the court held a first-day hearing at which Genco sought bankruptcy court approval of the RSA. Although approval of the RSA was opposed by certain of Genco's shareholders, the bankruptcy court overruled and approved the RSA on April 24, 2014.

After the first-day hearing, the U.S. Trustee declined to appoint a creditors' committee but, at the request of holders of Genco common stock (including some of those that

opposed the RSA), did appoint an equity committee. After appointment of the equity committee, the court postponed the start of the confirmation hearing by nine days to provide the equity committee with additional time to conduct discovery and take a position on the plan. Ultimately, the equity committee objected to confirmation of the prepack plan, contesting the debtor's valuation of its businesses and arguing that equity was entitled to a greater distribution. After expedited discovery and a four-day trial, the bankruptcy court overruled the objection, endorsed Genco's valuation methodology and confirmed the prepack plan on July 2, 2014. The plan went into effect on July 9, 2014.

Despite the appointment of an equity committee and a contested confirmation hearing, the prepack structure enabled Genco to expeditiously deleverage its balance sheet while minimizing operational disruptions. Genco emerged from bankruptcy after only 79 days with approximately \$1.2 billion less debt and largely unaffected trade creditors.

Conclusion

The prepack structure is an invaluable tool available to restructuring practitioners, which provides a viable alternative to a traditional chapter 11 filing. A prepack can offer a company a comparatively quick and efficient way to restructure its debt obligations with minimal operational disruptions and, even with unanticipated delays, allow a company to emerge from bankruptcy in a fraction of the time necessary for a traditional chapter 11 filing. **abi**

Editor's Note: For more insight on this topic, purchase *A Practitioner's Guide to Pre-Packaged Bankruptcy: A Primer*, now available in the ABI Bookstore (abi.org/bookstore). Members must log in first to obtain reduced pricing.

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¹⁷ Decl. of John C. Wobensmith Pursuant to Local Bankruptcy Rule 1007-2 and in Support of First Day Motions and Applications ¶ 62, *In re Genco Shipping & Trading Ltd., et al.*, Case No. 14-11108 (SHL) (Bankr. S.D.N.Y.), ECF No. 3.

¹⁸ *Id.* at ¶ 63.

Prepacks in the Southern District of New York

Case	Petition Date	Effective Date	Petition Date to Confirmation Date (Date of Confirmation Order)	Petition Date to Effective Date
Inversiones Alsacia SA	Oct. 16, 2014	Dec. 17, 2014	49 days (Dec. 4, 2014)	62 days
Eagle Bulk Shipping Inc.	Aug. 6, 2014	Oct. 15, 2014	47 days (Sept. 22, 2014)	70 days
Genco Shipping and Trading Ltd.	April 21, 2014	July 9, 2014	72 days (July 2, 2014)	79 days
Sbarro LLC	March 10, 2014	June 2, 2014	70 days (May 19, 2014)	84 days
American Roads LLC	July 25, 2013	Sept. 9, 2013	36 days (Aug. 30, 2013)	46 days
Newland Int'l Properties	April 30, 2013	July 3, 2013	30 days (May 30, 2013)	64 days
LodgeNet Interactive Corp.	Jan. 27, 2013	March 28, 2013	39 days (March 7, 2013)	60 days
Broadview Networks Holdings Inc.	Aug. 22, 2012	Nov. 13, 2012	42 days (Oct. 3, 2012)	83 days
Houghton Mifflin Harcourt Publishing Co.	May 21, 2012	June 22, 2012	31 days (June 21, 2012)	32 days
TBS Shipping Services Inc.	Feb. 6, 2012	April 12, 2012	52 days (March 29, 2012)	66 days
Jobson Medical Information LLC	Feb. 2, 2012	March 20, 2012	32 days (March 5, 2012)	47 days
Ener1 Inc.	Jan. 26, 2012	March 30, 2012	33 days (Feb. 28, 2012)	64 days