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5 Tips For A Perfect Prepackaged Bankruptcy Plan

By Maria Chutchian

Law360, New York (February 03, 2014, 4:35 PM ET) -- After a few high-profile prepackaged bankruptcy cases in the past year, attorneys need to avoid easy mistakes when dealing with debtholders and lock up support from their clients' major creditor constituencies as they embark on this type of Chapter 11, experts say.

A prepackaged bankruptcy, or "prepack," is attractive to attorneys and debt-ridden businesses for the obvious reasons — it saves debtors money and allows negotiations with creditors to be conducted without a judge or the public keeping tabs on their every move. But it requires months of preparations before the petition is finally filed and a string of precise steps to ensure that the plan doesn't fall apart when the debtors finally enter a courtroom.

"The run-up to the filing can take a long time. You're negotiating deals you'd normally do in bankruptcy court. Outside of bankruptcy, the advantage is you're not doing it in a fishbowl," said Kathryn A. Coleman of Hughes Hubbard & Reed LLP.

Here are five tips for crafting the perfect prepack:

Choose Prepackaged or Pre-Negotiated

The difference between a prepack and a pre-negotiated plan is key in that prepacks have creditor votes already completed, while pre-negotiated plans have an agreed-upon strategy but have not yet solicited votes. To effectuate a successful prepack, the company in distress must have sophisticated creditors who can be negotiated with as part of classes, while a pre-negotiated plan leaves room for unsecured creditors who are often widespread and difficult to corral to team up as a committee once the bankruptcy is filed.

"Prepacks are pretty rare because they require the consent of the required number of claimholders and all kinds of creditors classified under a plan of reorganization," said Ken Russak of Frandzel Robins Bloom & Csato LC. "It's a rare case that you don't have some dissident class of creditors that you have to deal with."

Though an unsuccessful prepack can often turn into a successful pre-negotiated plan, Russak said, it's important to know which best fits the company long before a petition is filed. If a prepack fails to garner the required votes and leaves certain creditors unhappy, it will almost certainly lead to litigation and cause expenses to balloon.

Know Your Debtholders

The type of debtholders a company has weighs significantly on whether a prepack is the best option for it to restructure its debt. Debt that has passed through various hands through distressed trading is far more complicated to deal with in a reorganization than debt that is simply held by banks, Coleman said.

“If there’s been a ton of trading in your debt and you’re seeing that it is going to the types of lenders who typically employ a loan-to-own strategy or are typically very activist in the context of a bankruptcy case, then I think it's unlikely that a prepack will work,” she said.

Outlying lenders will unquestionably make your negotiating and reorganizing efforts more difficult than if the debt were held by stable banks, she added. If a company’s debt has been traded extensively, it will be easier to go for a pre-negotiated plan instead.

Assess Value

It will be impossible to create a viable prepack without the trust of creditors, bondholders and ultimately the judge with respect to how much the company and its assets are worth, experts say. To win their backing, a thorough valuation and marketing process is necessary.

“You have to have a good, hard, solid appraisal — market value appraisal — that’s current, up to date, defensible, with good experts,” said Rhett Campbell of Thompson & Knight LLP.

Once attorneys have a credible valuation in hand, they can go to creditors and begin the process of determining who is entitled to what portion of the available funds, Campbell said. It’s crucial to make clear to creditors that what they are able to collect depends on where they fall in the capital structure of the company, he added.

Attorneys should also note in dealing with creditors that they are trying to get creditors the best possible outcome for the least amount of money in the least amount of time possible, he said.

If the debtor is hoping to sell its assets, a thorough marketing process is also key, Dov Kleiner of Kleinberg Kaplan Wolff & Cohen PC said. It’s easy for a creditor who opposes a sale to attack the marketing process, so attorneys need to be able to show a judge that nothing was overlooked.

Pay Attention to Time and Place

Determining where to file the bankruptcy is another important step when trying to create a prepack, Kleiner said. Many jurisdictions don’t have much history with prepacks, so it’s best to take the bankruptcy somewhere like the Southern District of New York, which has historically been kind to prepacks and has published guidelines.

Those guidelines include how much time is necessary for soliciting votes. While locking up the creditors’ votes is self-evident in conducting a prepack, the process could backfire if a judge believes that not enough time is given to review the disclosure statement and respond, according to Sam Stricklin of Bracewell & Giuliani LLP.

For example, in 1990, 7-Eleven parent company Southland Corp. was ordered to resolicit its votes in its prepack in part because a judge was unconvinced that creditors had enough time to review the disclosure statement and make a decision, Stricklin noted.

Leave Nothing Ambiguous

A prepack will not succeed if attorneys miscalculate the general number of unsecured creditors or how much they will demand in recoveries and how far they will go to achieve them. To avoid such an outcome, attorneys must nail down what to expect from each creditor — or members of a certain class of creditors —

and be as clear as possible about how much each class can expect through a restructuring or sale, experts said.

“Typically, when you are undertaking a prepackaged plan, you would probably want to keep your trade creditors and smaller creditor pools unimpaired so you don’t have to solicit those groups of creditors and only try to deal with large creditor parties like bonds and senior secured debt so you have a large group you can negotiate with rather than disparate groups that are hard to negotiate with,” Stricklin said.

It’s next to impossible to negotiate if a company’s general unsecured creditors are numerous and far-flung, Campbell noted. To avoid making them upset and drawing potential litigation, it’s best to pay them off in full if possible, experts said.

Doing so will gain the company a lot more sympathy from the court if a handful of creditors within a consenting class hold out and demand more, according to Kleiner.

“The most common mistake is ignoring a constituency that you thought was inactive,” Kleiner said.

--Editing by Jeremy Barker and Philip Shea.

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