Riding the Express Lane Through BANKRUPTCY

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EXPEDITED BANKRUPTCY

When a company is on the bankruptcy highway, one of the goals is to exit as quickly and smoothly as possible, leaving the uncertainty of the process behind and putting all of management's time into optimizing the business. It's no wonder, then, that two recent ultrafast bankruptcy cases have caught the attention of the U.S. restructuring community.

The reorganization plans of plus-size apparel retailer FullBeauty Brands Holdings Corp. and technology-related disaster and recovery services provider Sungard Availability Services Capital Inc. were both confirmed within 24 hours of filing in February and May of this year, respectively. FullBeauty and Sungard are the first so-called express Chapter 11 cases since the U.S. Bankruptcy Court for the District of Nevada approved the plan of Bluebird Bus Company in under 48 hours in 2006. With two cases in a span of four months, it's worth asking if this superfast take on the prepackaged Chapter 11 filing has created a model for the future.

A critical point to note is that the concept of a prepackaged bankruptcy filing is not novel. The prepack has been around since the 1980s but picked up pace in the last decade as investors focused on fast balance sheet restructurings. Prepacks are an appropriate option when creditors can agree in advance to restructuring terms and a Chapter 11 process is not needed to effectuate a broader operational restructuring. So, what is the advantage of further expediting an already abridged process? Why not pursue a regular prepack lasting a more common period of, say, 30 or 60 days?

The overarching argument to be made for a superfast bankruptcy filing is that the shorter time frame minimizes operational disruption and potential value degradation. There are a few critical drivers of intrinsic value that benefit immensely from an even quicker exit from Chapter 11 proceedings than in a typical prepack:

1 **Positive messaging opportunities.** The ability to announce a universally accepted and approved deal for which implementation is imminent gives a distressed company a rare opportunity to proactively message the market. An executed restructuring support agreement is always a constructive development, but the news is much more impactful when the company can announce its intention to be in and out of bankruptcy within a profoundly curtailed time frame, such as under a day.

And the quicker the balance sheet fix, the sooner management can focus on running the business while also avoiding conversations with

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customers, vendors, employees, and other day-to-day stakeholders about its ongoing bankruptcy process. Having an agreed-upon, unambiguous path to a restructured balance sheet and a viable operating plan allows the company to make critical day-to-day decisions that drive value going forward.

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2 Mitigating trade contraction. Most bankruptcy experts, especially financial advisors, are familiar with the liquidity management issues driven by vendor concerns in the face of a Chapter 11 filing. Potential problems include reductions in trade terms, demands for cash upon delivery, deposit requests, stop ship orders, etc., while the company navigates the solicitation period between announcing its intent to file and the actual filing. Assurances of regular payments help alleviate some vendor concerns in a regular prepack process.

However, not all vendors are willing to weather the uncertainty of even a 30- to 60-day period, and a subset may still demand some form of financial reassurance. The communication of a fully consensual balance sheet restructuring with the intent of a 24-hour bankruptcy process, however, helps better equip management to neutralize nervous vendor demands and ultimately removes ambiguity from the cash flow forecasting process.

3 Protecting the customer base. In addition to providing the company and its advisors with the opportunity to manage outflows with more predictability, an express prepack can also benefit the top line. It's common knowledge that the preservation of a distressed company's core customer base is critical to its ability to successfully execute a turnaround plan.

The risk of losing customers is even more pressing in business-to-business situations, where they tend to be more acutely concerned about the risks a distressed counterparty poses to their own operations. In these situations, the strength of relationships plays an outsized role in whether a company can retain its customer base. In these conversations, where customer nerves are sometimes understandably frayed, the ability to assure them that an overleveraged balance sheet has been restructured is a huge boost. In fact, depending on the situation, it may be possible for a highly effective sales team to generate hype and even drive a sales pop on the back of such a message.

4 Retaining key employees. One of the biggest tactical challenges for a management team navigating a restructuring process, especially an in-court process, is maximizing employee retention and maintaining morale. While a significant number of Chapter 11s include key employee incentive plan and key employee retention plan motions that cover the executive team and other mission-critical positions, a majority of mid- or lower-level employees are not included. In drawn-out bankruptcy cases, this dynamic can lead to a disaffected mid-tier of the organization and potentially to a damaging loss of talent.

The stated intent of an almost-immediate bankruptcy emergence, on the other hand, gives employees at all levels of the organization a morale boost and an indication that the company is moving in a positive direction. It is clear evidence that the new owners are not willing to drag the business through a potentially value-destructive court process. It also makes employees' day-to-day jobs easier, whether it's the sales department assuaging customers or the accounting department, which can now avoid most of the arduous bankruptcy reporting requirements.

5 Minimizing reputational damage. An inherent byproduct of each of the previously discussed benefits is the company's ability to minimize reputational damage, whether among the external customer and vendor universe or the internal employee base. As a distressed company sits in bankruptcy, it becomes increasingly susceptible to negative publicity, regardless of whether a prepack deal is in place.

Of course, every Chapter 11 case should be assessed on its unique dynamics. Nonetheless, it is safe to assume that no ownership group or management team wants to spend precious time and resources dealing with a public adjudication. Therefore, the announcement of a quick and consensual balance sheet cleanup through an express prepack allows the financial fix to take center stage and offers an encouraging message to all stakeholders.

6 Reducing process costs. In an express prepack, since the overall process is quicker, the costs to the company involved in the bankruptcy proceedings tend to be lower as well. The duration for which the firm must retain the services of a full suite of advisors—financial advisors, public relations firms, restructuring advisors, law firms, claims agents, etc.—is reduced significantly. So, the shorter the filing period is, the lower the cost to the company.

In addition to reduced professional fees, the company is also able to avoid the fees and expenses related to raising debtor-in-possession financing, because

additional financing should not be needed for such a short period in bankruptcy. Moreover, because restructuring costs typically cease upon emergence, the quicker the filing is completed, the quicker management can refocus on deploying capital toward true growth and operational improvement initiatives.

One common criticism associated with the ultrafast prepack is that such a process forgoes the opportunity for integral operational cleanup afforded by the bankruptcy process. But while all claims ride through in an express prepack—much like in a typical prepack—the pursuit of an ultrafast approval does not mean the debtors cannot reject unfavorable leases or vendor contracts. In the *Sungard* case, for example, the debtors rejected four unfavorable leases while paying out full claims under Section 502(b)(6) of the U.S. Bankruptcy Code. Where operational expense pruning, such as the rejection of leases, is appropriate, a cost-benefit analysis can determine if it is better to pay the claim in full and enjoy the upsides of an express prepack or impair the claims and bear the costs of remaining in bankruptcy longer. In the latter scenario, those landlords or vendors will presumably be represented by an official committee, which is unlikely to be pro bono.

In addition, bankruptcy advisors and management teams can and should use the period in the leadup to a filing to actively negotiate for improved terms on unfavorable contracts, regardless of the speed of the Chapter 11 process. Many vendors and landlords are not entirely au fait with the differences among the various types of bankruptcy proceedings, let alone those between express and regular prepacks. As a result, just bringing up the bankruptcy can go a long way in helping management drive improved terms through renegotiations, alleviating the need to reject contracts after filing.

While the overarching goal of the bankruptcy process is to right-size a distressed company's capital structure, most companies that pursue an in-court restructuring have already been working on the operational improvements needed to achieve a truly successful whole-company turnaround. Without efficient operations and a viable business plan, the company may face future distress, regardless of the speed and efficiency of its bankruptcy process.

Conclusion

Ultimately, the duration of the court process and the success of a turnaround effort are not necessarily correlated. But if a company and its creditors can agree on a plan of reorganization prior to filing and the former can satisfy all the process requirements of the court, then an express prepack may be a viable option.

The complexity of the capital structure and the objectives of each impaired class of creditors play pivotal roles in determining whether an ultrafast, in-court solution is possible.

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The more unified the deal is, the higher the probability of being able to accomplish an express prepack.

Even in cases where all creditor groups agree on a deal, sufficient preparation time and a healthy liquidity status remain necessary prerequisites. A successful express prepack restructuring is the result of months of extensive behind-the-scenes preparation, including an assessment of strategic alternatives, business planning, scenario modeling, cash flow forecasting, exit financing negotiations, and, critically, the successful outcome of complex negotiations amongst the debtor and its various creditor constituencies.

To accomplish this, it's imperative that early action be taken by boards and management teams to begin working with restructuring advisors and engaging key creditors. The company must also ensure that it has a sufficient liquidity runway to smoothly navigate the months of negotiations to get to a deal, the one-month solicitation period beginning with the announcement of the intent to file, and the eventual filing, emergence, and recapitalization of the business.

Ultimately, the benefits of getting the company's new owners into the driver's seat as quickly and with as little operational disruption as possible can be significant and give the business an enhanced chance of executing a successful turnaround while maximizing post-emergence value. ■