

## VIEWPOINT

## The Market Responds To Code Changes With Fewer Reorganizations

By Harold D. Israel, Kaye Scholer LLC  
and Carl S. Lane, Deloitte Financial Advisory Services LLP



Harold D. Israel



Carl S. Lane

One of a series of opinion columns by bankruptcy industry participants.

On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. We conducted an analysis of cases filed since October 17, 2005, the effective date of the changes, through May 2006, to determine how debtors have responded to these amendments. In the months leading up to the effective date of the changes, we heard numerous predictions that they would lead to a decrease in the number of “pure” reorganization cases. Did the prognosticators get it right?

In a word, yes. As the results of our analysis demonstrate, there appears to be a significant increase in Chapter 11 filings contemplating prepackaged/prearranged plans of reorganization or first-day sales of substantially all of the company’s assets compared to filings in 2004 and 2005 prior to the effective date and a corresponding decrease in the number of “traditional” reorganization cases.

The Code amendments increased the initial time for a debtor to assume or reject a lease of non-residential real property from 60 days after the petition date until the earlier of (i) 120 days after the petition date or (ii) entry of the confirmation order, but limited a court’s ability to extend the 120-day period for more than 90 days (i.e., through the 210th day, or seven months after the petition date), unless the affected landlord consents in writing to a longer extension. (See 11 U.S.C. Section 365(d)(4).) Additionally, while the amendments didn’t change either the 120-day period for which only a debtor may file a plan of reorganization or the 180-day period that only a debtor may solicit acceptances of such a plan, it severely curtailed a court’s discretion by providing that it shall not extend (i) the 120-day exclusivity period beyond 18 months past the petition date as well as (ii) the 180-day solicitation period beyond 20 months past the petition date. (See 11 U.S.C. Section 1121(d).) Under the prior law, courts had wide discretion to increase each of these deadlines, and routinely exercised this discretion.

Many of the leading bankruptcy professionals predicted that we would see fewer “pure” reorganization cases and an increase in the filing of prepackaged or prearranged plans of reorganization or sales of substantially all of a debtor’s assets early in the case. The underlying theory was that debtors wouldn’t have sufficient time to reorganize because of the limits placed on their ability to seek extensions of the time to assume or reject leases and of the exclusive time to file and obtain acceptances of a plan of reorganization.

### Filing of Reorganization Cases Prior to the Effective Date

In the months leading up to the effective date, we saw the filing of several “mega” reorganization cases, including those of **Northwest Airlines Corp.**, **Delta Airlines Inc.**, and **Delphi Corp.**

While each of the companies that were the subject of these filings operate in what are generally considered to be troubled industries, the timing of these filings suggest that they were filed to avoid the impact of the changes to sections 365 and 1121 of the U.S. Bankruptcy Code. In each case, the time for the debtors to assume or reject unexpired leases has been extended for a period in excess of 210 days past the filing date. Under the code changes, these entities would have had to already determine which leases to assume or reject, unless the affected landlord consented to a longer period of time. With respect to plans of reorganization, recent history in both the airline and automotive parts supplier industries suggest that, while possible, it is unlikely that any of these debtors will complete the solicitation of votes with respect to a plan of reorganization within 20 months of their respective filing dates.

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### Trend Away From Reorganization Cases After the Effective Date

We performed a survey of Chapter 11 filings of companies with greater than \$50 million in debt, including 33 filings after the Code changes, and 103 filings in 2004 and 2005 before the Code changes. Based on our review of bankruptcy court filings and media reports, the cases were classified into four categories based on preliminary case indications: 1) reorganizations, 2) prepackaged/prearranged plans, 3) sales and 4) liquidations. We then calculated the proportion of each type of case for the post and pre-amendment periods.

	ALL DEBTORS		EXCLUDING AUTO AND AIR	
	BEFORE OCT. 17 CHANGES	AFTER OCT. 17 CHANGES	BEFORE OCT. 17 CHANGES	AFTER OCT. 17 CHANGES
Reorganizations	57%	30%	52%	27%
Prepackaged and Prearranged Plans	16%	33%	18%	35%
Sales and Liquidations	27%	36%	30%	38%
<b>Prepackaged and Prearranged Plans, Sales and Liquidations</b>	<b>43%</b>	<b>70%</b>	<b>48%</b>	<b>73%</b>

*Sources: Bankruptcy Court filings, media reports and press releases; Deloitte FAS research*

The change in the proportion of prepackaged/prearranged plans and sales or liquidations is dramatic. The proportion of prepackaged/prearranged plans alone has more than doubled, increasing from 16% before the Code changes to 33% after the amendments, while the combined proportion prepackaged/prearranged plans and sales and or liquidations has increased 63%, increasing from 43% before the changes to 70% after. Conversely, the proportion of "pure" reorganizations has declined from 57% before the changes to 30% after. The change in the proportion of prepackaged/prearranged plans when 2004 filings are excluded is even more dramatic, likely due to the rush to file before the effective date. It should also be noted that the aforementioned statistics don't change dramatically when the analysis is adjusted for potential industry influences (e.g., automotive and airline industry filings).

We have yet to see the full impact of the accelerated decision-making provisions in the Code changes because no case has matured to the stage where the new deadlines would have full impact. How debtors and courts handle reorganization cases as they reach these deadlines will go a long way in influencing whether this trend away from reorganizations will continue.

***Opinions expressed are those of the authors, not of Dow Jones Newsletters.***

*Harold D. Israel is counsel in the Business Reorganization and Creditors' Rights Department of Kaye Scholer. Kaye Scholer represents clients in all aspects of corporate turnarounds and financial restructurings. His opinions in this article do not necessarily represent those of Kaye Scholer. Mr. Israel can be reached at 312-583-2333 or via email at hisrael@kayescholer.com.*

*Carl S. Lane is a principal of Deloitte Financial Advisory Services LLP based in Chicago and the practice leader of the Reorganizations Services Group in the Midwest. His opinions do not necessarily represent those of Deloitte Financial Advisory Services. Mr. Lane can be reached at 312-486-3069 or via email at carlane@deloitte.com.*