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BANKRUPTCY
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2019 Winter Leadership Conference

Avoiding Chapters 22, 33 and 44: Feasibility and Plan Confirmation

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CONCURRENT SESSION

2019

Chapter 22 Study
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Chapter 11 is a reorganization tool for companies. It is a mechanism that businesses use in many different ways to complete business strategies, such as an operational or balance sheet restructuring or a recapitalization. While many companies are successful using the Chapter 11 process to restructure, some companies underestimate their operational challenges or the sustainability of their balance sheet and wind-up back in Chapter 11 after a period of time. This second filing – regularly referred to in the industry as a "Chapter 22" – often raises the question: how viable was the original business plan if the Debtors needed to seek court protection a second time?

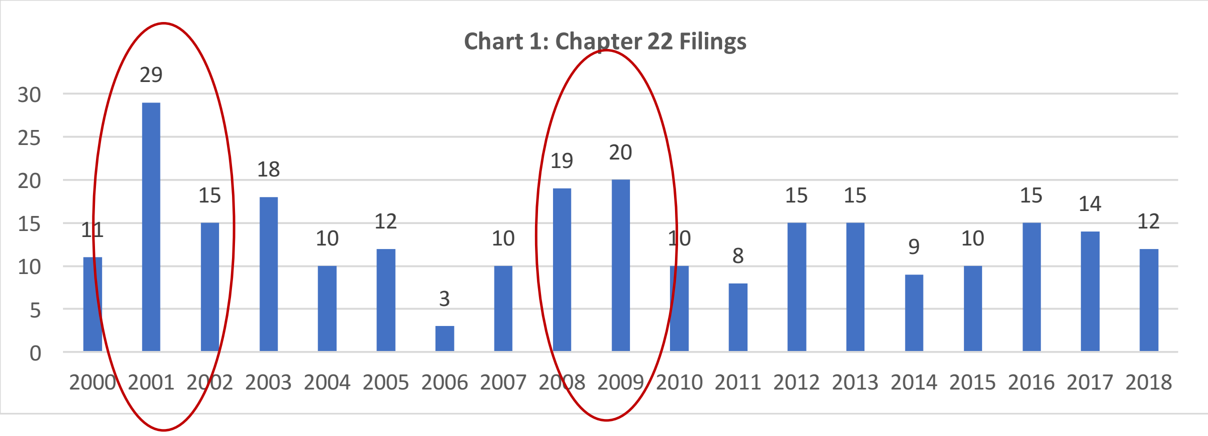
When drafting the Bankruptcy Code, Congress thought that the question of the viability of the business plan was an important one to answer in the context of a Debtor trying to rehabilitate itself. Per Section 1129(a)(11), "the court shall only confirm a plan if all of the following requirements are met…confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed by the plan." Though practitioners have debated over what the term "likely" means in the context of feasibility, the intent of Congress was clear: the Bankruptcy Court should not confirm a plan if there is a significant risk that the Debtor or its successors will require a further restructuring in the future.

The requirement in 1129(a), often referred to as the feasibility requirement, provides a minimum threshold for the Bankruptcy Court to consider. It should be noted however that this threshold is not usually seen as a requirement to take into account all of the potential challenges a company emerging from bankruptcy may encounter. Rather, it is an evaluation of whether it is likely that implementation of the plan will lead to further restructuring activity.

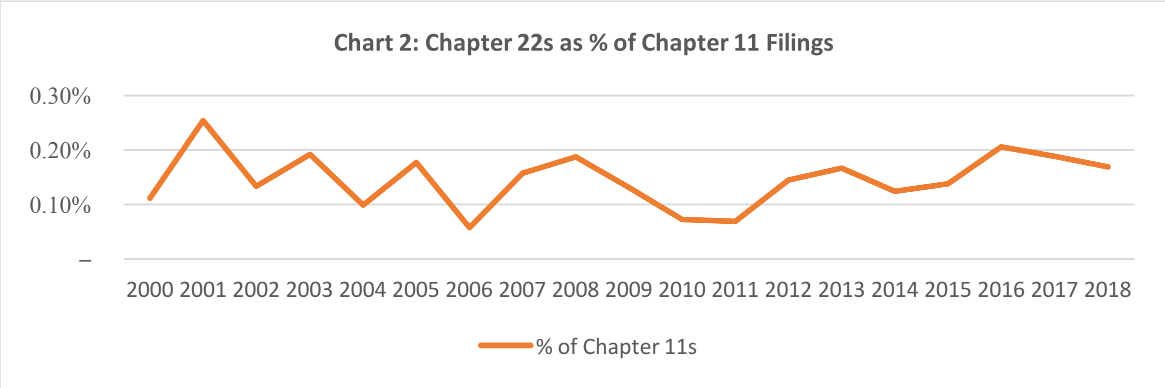
Perspective
American Apparel. Gymboree. Payless. Wet Seal. Charming Charlie. These are formerly iconic names familiar to anyone who has walked through a shopping mall in the last ten years. Other names are less well known, such as Hercules Offshore, Vanguard Natural Resources Veneco, Fansteel and PES Holdings. Regardless of their level of brand awareness, all of these companies have one thing in common, the commencement of a "Chapter 22" filing .

Before delving into the underlying drivers of the Chapter 22 filing, it is important to put some facts into perspective. First, Chapter 22s unsurprisingly appear to spike during periods of economic challenge such as the dot-come/tech bust in 2001 and the start of the Recession in 2008-2009:[1]

[1] Source: Bankrutpcydata.com



However, when we compare the number of these filings against all the Chapter 11 filings that took place in a given year, it's difficult to make a case that Chapter 22s are 'on the rise':[2]



Since 2000, on average, Chapter 22s accounted for less than 0.15% of Chapter 11 filings. Put another way, the likelihood of a plan that has been confirmed by the court resulting in a second restructuring is small.

Timing of Filings

Debtor financial projections typically run out five years, though shorter projection periods do occur. In fairness to the companies putting together projections, being accurate out five years can be a challenge. Given the increased frequency of economic cycles and increasing disruption from industry shifts, it can be difficult to accurately project the operating landscape that a Debtor confirming a plan may face even three years into the future.

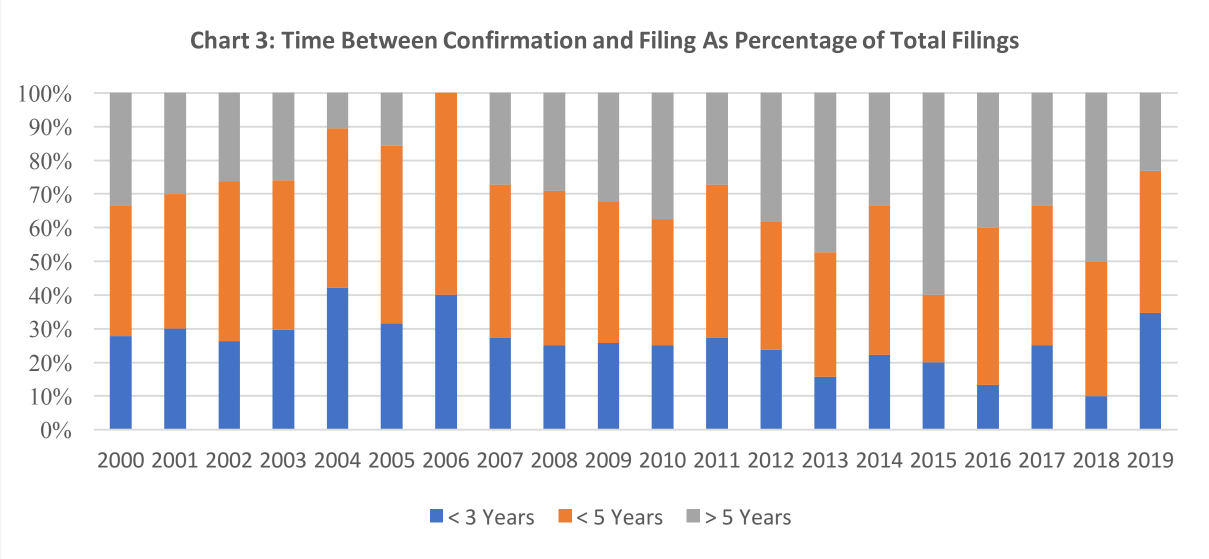
Looking back over the historical Chapter 22 filings noted above, the average time from plan confirmation to the next Chapter 11 filings is 5.4 years. The table below provides further details:

Time from Confirmation to Next Filing	Count	% of Total
Greater than 5 Years	114	41.3%
Under 5 Years	162	58.7%
Under 4 Years	137	49.6%

[2] Source: Bankruptcydata.com and AlixPartners analysis

Under 3 Years	102	37.0%
Under 2 Years	55	19.9%
Under 1 Year	17	6.2%

More than 60% of Debtors who file for Chapter 22 make it at least three years, and over 40% go at least five years before a second filing. Where things get interesting is when we look at the timing of filings as it relates to the year of filing:[3]



In looking at how much time transpired from when debtors had their plans confirmed to their next Chapter 22 filing as a percentage of the total filings within a year, there are a few points that stand out:

- Until 2010, companies that filed for Chapter 22 were more likely to do so within five years of confirmation: on average, only 32% of companies had more than five years between confirmation and petition. Further, only 55% of companies had more than three years between confirmation and petition.
- From 2010 to 2018 however, almost 50% of companies had at least five years between confirmation and the Chapter 22 petition and 71% of these companies had at least three years between confirmation and petition.
- Comparatively, 2019 is a bit of an anomaly: of the 19 companies filing for Chapter 22[4], only 35% of companies had more than five years between confirmation and petition and only 47% of these companies made it more than three years between the most recent confirmation and petition.

All told, the data suggests that, in general, a debtor whose plan is confirmed by the court is overwhelming likely to not find itself back in bankruptcy proceedings closely after its initial emergence (if at all). As noted earlier, this doesn't necessarily mean that the emerging company is a success. But it does strongly imply that the feasibility requirement – and the ecosystem of the court, debtors, advisors,

[3] Source: Bankruptcydata.com, AlixPartners analysis. Note: only includes filings where a confirmation date is known
[4] As of August 31, 2019

creditors, investors and other stakeholders that may be responsible for developing, reviewing and ultimately confirming the plan – is, clearly, working.

But what about those instances where it doesn't work? Why does that happen and what can be learned from those experiences to reduce the possibility of a second restructuring even further?

The AlixPartners Chapter 22 Study

The AlixPartners Chapter 22 Study analyzed 65 companies or ~70% of the Chapter 22 filings that occurred from 2013 through 2019, primarily through a review of the Debtor's First Day Declaration for the second filing.

The Study evaluated factors ranging from the Debtor's reliance on significant improvements post filing and the underlying operating model to the impact of industry/market issues (including declines in commodity prices), capitalization and liquidity pressures, unusual events and general business operations. In general, Debtors that sought a second restructuring had multiple underlying factors that contributed to their filing and, through the Study, certain themes clearly stood out:

<u>The Best Laid Plans</u>

The number one issue that drove companies back into an in-court restructuring was limitations of the company's operating model, which in more than 65% of cases was a significant cause of distress. This was typically due to shifts in the market for the company's product, which hampered the company's topline growth.

For some businesses, the challenge was the inability to accommodate changes in customer preferences and buyer behavior. Other companies – such as oil & gas related businesses – pegged their post-confirmation capital structures to cash flows that required a certain level of commodity pricing that never materialized.

Often, companies also failed to achieve any significant operational improvement after emergence. For 28 companies (or over 40% of the companies reviewed), efforts to follow through on their plans to enhance the productivity of their business was a key factor that led to a Chapter 22 filing. Some Debtors were quite clear in this:

> *American Apparel: "Unfortunately, that turnaround plan was not successful and the anticipated stabilization and gains in revenue were not fully realized"*
>
> *Ditech: "Notwithstanding the Company's efforts to implement its business plan…. the Company continued to face liquidity and performance challenges that were more persistent and widespread than anticipated"*
>
> *Fired Up, Inc: "the Company's best-laid plans in its First Case have been thwarted"*

<u>Changes in Industry and Shifts in Market</u>

Market shifts can be inherently difficult for a company to react to. Usually tied to challenges in a company's underlying operating model, a company's ability to make meaningful productivity improvements or enhancements to products post-emergence can be severely impacted by market shifts, resulting in significant loss of revenue.

Retail and oil & gas companies represented a significant portion of the Chapter 22 filings between 2013 to 2019 (19% and 16% respectively), and for these debtors, industry and market/shifts played a major role in their second filing.

For retailers, the shift away from traffic in mall-based stores was consistently cited as being a fundamental challenge to the Debtor's operations. However, the decline in foot traffic is not a new phenomenon, suggesting that both retailers and investors struggled to understand how much in-store sales performance could underperform expectations.

> *Charming Charlies: "The Debtors, along with many other apparel and retail companies continue to face a challenging commercial environment brought on by increased competition and the shift away from shopping at brick-and-mortar stores"*
>
> *Gymboree: "Gymboree faced a competitive retail environment made more challenging by a shift away from traditional shopping at brick and mortar stores towards a more online-centric platform."*

For companies in the oil & gas space, fracking put pressure on market pricing by creating high inventory levels. This factor, combined with heavy debt loads, often proved to be an insurmountable obstacle to meeting financial projections regardless of efforts made by the Debtor to reduce fixed debt costs and limit capital expenditures. This proved to be true regardless of whether the Debtor was an E&P or a services company.

> *Global Geophysical Services: "As currently organized, the Debtors do not have a business plan that can withstand the trough in commodity prices and the associated decline in capital expenditures in the exploration market."*
>
> *Vanguard National: "The difficulties faced by the Debtors are consistent with those faced industry-wide."*

Mining & Metals companies faced a similar challenge:

> *Patriot Coal: "Patriot's feasibility upon emergence from the 2012-13 Restructuring was predicated on assumptions about coal prices that ultimately did not to materialize."*
>
> *Ormet: "The last couple years have demonstrated the risks inherent in operating a business with revenues directly tied to the price of internationally traded commodities."*

Media companies have wrestled with the profound impact of the internet, with the more traditional enterprises struggling to anticipate how different the environment could be.

> *Dex Media:" At the time of their merger, the Debtors expected that the extended runway of their debt facilities, combined with cost synergies resulting from the merger, would give them sufficient breathing room to overcome the aforementioned negative trends in the directories industry. Unfortunately, many of the same macro challenges continue to affect the Debtors today".*

<u>Regulatory and Litigation Pressures Can Play Their Part</u>

Regulatory issues and unanticipated litigation are often overlooked factors when analyzing why a company's plan failed to come to fruition. More than 10% of the companies reviewed were significantly impacted by changes in regulations as well as litigation against the business. In some cases, these actions proved to be critical events forcing the debtor to seek court protection.

> *21st Century Oncology: "the Company has experienced material one-time cash outflows in connection with the settlement of certain litigations brought against one or more of the Debtors."*
>
> *Life Card Holdings: "In 2015, Medicare's establishment of patient criteria to qualify as an LTAC-compliant patient facility led to significant reimbursement rate declines over the course of 2015 and 2016 as changes were implemented"*

<u>And in Some Cases, Specific Unanticipated Events are Major Contributors to Distress</u>

Almost 20% of repeat filers were impacted by events that they generally had limited control over and/or didn't have the resources to prevent or to manage through. These events included the truly disastrous – such as destruction of property by fire and the aftermath costs and claims– to entering into agreements with contractors whose work may be classified as negligent or worse.

> *PG&E: "On November 8, 2018, a wildfire began near the city of Paradise, Butte County, California…"*
>
> *Philadelphia Energy Solutions: "the Debtors suffered a historic, large-scale, catastrophic incident involving an explosion at the alkylation unit at their Girard Point refining facility."*
>
> *Lightning Dock Geothermal: "In my 25 years of executive experience in the energy industry, during which I have dealt with numerous international companies, I have never witnessed such a serious intentional violation of international law by a contract counterparty."*

For four of the sixty-five debtors, the loss of a major customer or a steep drop in customer spending caused severe damage to the business.

> *Constar: "despite the deleveraging that occurred in the Second Bankruptcy Case, the loss of its largest customer forced the Company to further consolidate its operations"*
>
> *Fansteel: "The 2013 US military drawdown in Afghanistan followed by the precipitous drop in oil prices in 2015 caused two sharp declines in demand for helicopter parts."*

<u>Capital Structures May Not Be Sized for Low Case Scenarios</u>

Post-emergence capital structures are based on companies meeting financial projections. Misses to those projections – for many of the reasons noted above – can quickly turn a supportive capital structure untenable or make it difficult for companies to raise new funds.

> *Fox & Hound: "…Debtors were unable to grow their businesses back to a level commensurate with their existing capital structure."*
>
> *Relativity Media: "the Company was unable to secure the debt or equity capital necessary to execute on its business plan after it reorganized in 2016."*

Liquidity Constraints:
The factors noted above contributed in various ways to the ultimate cause of a filing for many companies, liquidity constraints, even when the fundamental business itself was strong.

> *Hexion Specialty Chemicals: "….a strong business with a history of success and excellent long-term prospects….As debt service has remained high, liquidity has become a critical issue."*
>
> *Maxcom Telecom USA: "The Debtors' negative cash flows have limited its ability to invest in its operations by replacing or upgrading its infrastructure and technologies"*
>
> *Halcon Resources: "…a decline in commodity prices, combined with the unanticipated operational issues and the resulting covenant violation under the RBL Agreement, lead to a dramatic reduction in the Company's liquidity."*
>
> *Exide Technologies: "Constrained liquidity also has limited Exide's ability to invest in its businesses, primarily in North America, causing the Company to be at a competitive disadvantage relative to bigger, better-capitalized competitors."*

The "Hangover Effect"
Finally, an often overlooked – and under discussed – challenge companies emerging from a restructuring can face is what we have named "the hangover effect". This is when issues from the prior restructuring carry over into the emerged company. This can often show up in challenges related to the supply chain as well as customer behavior.

> *Eastern Outfitters: "Following the July 18, 2016 sale (by Vestis), the Debtors' vendors imposed very restrictive credit terms on the Debtors' businesses.*
>
> *Payless: "Due to interruptions in production during the Prior Cases, the Debtors' key supplier factories took longer than expected to procure the raw materials and workers required for the Debtors to deliver their products in a timely manner. The delayed production caused a major inventory flow disruption during the 2017 Holiday season"*
>
> *Heritage Home Brands: "From its inception in late 2013, Heritage's sales have been heavily impacted by the negative effects of the Furniture Brands bankruptcy. Following years of sales declines, many furniture retailers had lost faith in the ability of the Company to produce, deliver, and service its products, and the bankruptcy led many of them to shift their purchases to a variety of competitors or even further utilize their own private label offerings."*
>
> *Bacharach: "Possibly exacerbated by reputational harm from the bankruptcy filing, the Company's sales have consistently been 20% lower than projected."*
>
> *Deb Stores: "Deb's recent performance has been strained due to a combination of factors, including historic lack of capital invested in business resulting in old tired store."*

A Lens on 2019
As previously noted, 2019 has been a bit of an anomaly, with 19 companies filing for Chapter 22 through September 2019 – the highest number of Chapter 22 filings since 2008. The below table breaks out

these companies, the number of years from the confirmation of their first filing to their next filing, and the major factors that appear to have led to a second filing:

#	Company Name	Ch 11 Confirm	Ch 22 Filing	Years from Confirm to Ch 22	Industry	Operating Model	Fail to Improve	Capital and Covenants	Liquidity	Industry/ Market	Regulatory	Event Driven or Unusual?
1	A'Gaci	7/27/18	8/7/19	1.0	Retail	●	◕	○	●	○	○	○
2	Avenue (Store)	9/18/12	8/16/19	6.9	Retail	◕	◔	○	◕	●	○	○
3	Barney's	12/12/98	8/6/19	20.7	Retail	●	○	○	●	◕	○	○
4	Bayou Steel	2/6/04	10/1/19	15.7	Metals	◑	○	●	●	○	○	○
5	Charming Charlie	4/3/18	7/11/19	1.3	Retail	●	◕	◕	○	◕	◕	◕
6	Clare Oaks	11/15/12	6/11/19	6.6	Healthcare	●	◕	◕	◕	○	○	○
7	Ditech	2/9/18	2/11/19	1.0	Financial	○	◕	◕	◕	◕	◕	○
8	Gymboree	9/29/17	1/17/19	1.3	Retail	●	●	○	○	●	○	○
9	Halcon Resources	9/8/16	8/7/19	2.9	Oil & Gas	●	○	◕	◕	○	○	○
10	Hexion/Momentive	9/11/14	4/1/19	4.6	Chemicals	◔	○	◕	◕	◑	○	○
11	Hilltop Energy	2/17/16	5/16/19	3.2	Oil & Gas	●	◔	◑	○	◔	○	○
12	LifeCare	4/4/13	5/6/19	6.1	Healthcare	◕	◔	◑	○	○	●	○
13	Maxcom Telecom	9/10/13	8/19/19	5.9	Telecom	◕	○	◕	○	○	◕	○
14	Payless	8/10/17	2/18/19	1.5	Retail	●	◕	○	○	◕	○	○
15	Perkins & Marie	11/1/11	8/5/19	7.8	Restaurant	◕	◔	◕	○	◕	○	○
16	PG&E	1/9/04	1/29/19	15.1	Energy	◕	◕	○	◕	○	○	●
17	PES	8/7/18	7/22/19	1.0	Oil & Gas	○	○	○	○	○	○	●
18	Southcross	4/11/16	4/1/19	3.0	Oil & Gas	◔	◔	◕	◕	●	○	○
19	Vanguard Natural	8/1/17	4/1/19	1.7	Oil & Gas	◕	●	◕	◕	◕	○	○
	Key:	●	Major	◕	Significant	◑	Moderate	◔	Minor	○	No issues called out	

The table is reflective of virtually all of the factors previously discussed as contributing to a secondary in court restructuring. In looking at the major industries that make up the 19 filers – 12 are in industries that have experienced either significant ongoing changes to the core business proposition (retail) or whose business models are tied to commodity pricing that has stayed problematic (oil & gas and metals).

Of note is how many of these companies had confirmed plans within the past three years suggesting that the views of the Debtors – and what they thought would be achievable in regards to improved performance or improvements in commodity prices – may have been overly optimistic.

A Few Takeaways

The data around repeat filers strongly suggest that, the restructuring ecosystem of the court – the Debtor and the key stakeholders and advisors – are consistently developing and confirming plans that are "not likely to be followed by the liquidation, or the need for further financial reorganization."

However, to the extent that the factors that contribute to the Chapter 22 filings of the past several years can be useful in helping to bolster plan feasibility, here are six things that plan architects, advisors, stakeholders and the court may pay special attention to:

- **Focus on Achievable Plans:** Management teams that put aggressive goals in their plans, particularly when trying to justify a more leveraged capital structure, often find that they have difficulty achieving those plans once they emerge from bankruptcy. Advisors should help to pressure test the management team's goals and insure that there is a reasonable path for them to achieve their projections. *Certain chapter 22 filings could have easily been avoided if the capital structure was reset properly the first time and not based on overly aggressive plans.*
- **Reliance on Pricing**: Plans whose capital structure is built around pricing increases driving enough cash flow to be sustainable are especially vulnerable to distress if market pricing declines. *Ways to manage this include using current pricing and industry activity level for*

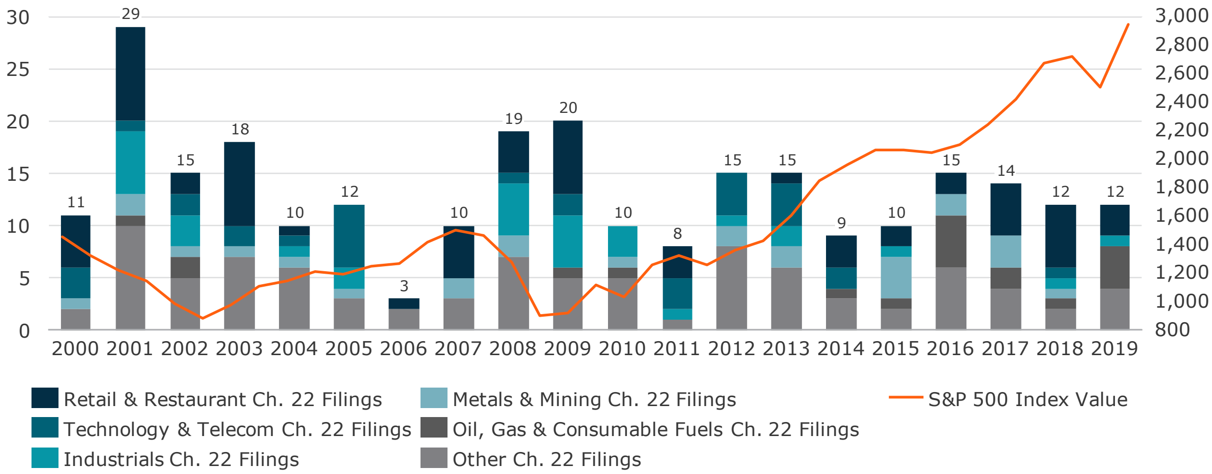
baseline projections and then building in meaningful downside risks that include lower levels of pricing existing for longer periods of time.

- **Customer Concentration**: Customer concentration is a risk for any business. As a few of the companies in the Study demonstrated, when a company is so dependent on ongoing business with a small group of customers, its overall risk profile can increase dramatically. *Plans should be assessed not just in terms of overall performance but for their exposure to large buyers.*
- **Relevance of the Operating Model:** Companies emerging into industries that have experienced fundamental changes in the operating model – such as retail – cannot rely on traditional operating levers such as store closures and rent reductions. Further, the challenges in developing of enhancements to the operating model – such as creating a true omnichannel experience for shoppers – are easy to underestimate. *In evaluating these business plans and financial projections, special attention should be paid to both how they integrate in current customer behavior as well as realistic assessment of the timeline and expense associated with improvements to the operating model.*
- **The Hangover Effect:** As noted earlier, it is easy to overlook the potential 'hangover effect' of the first Chapter 11 filing and assume that the confirmation of a plan and the emergence from a restructuring provides a fresh start. Unfortunately, for many of the company's stakeholders – from customers to vendors to employees – concerns may still exist about the company's overall commitment and ability to provide quality products and services to its customers and timely payments to its suppliers. This in turn can lead to lower receipts and a slower return to 'normalized' payment terms. *Scenario planning should take into account a slower return of customers as well as a slower return to normalized payment terms (for both customers and vendors).*
- **Liquidity is King:** As with any company, liquidity is the grease that oils the machine and keeps the business thriving. Make sure that the Plan takes into account any one-time liquidity drains or working capital swings that might jeopardize the implementation of the plan. *Maintaining practices learned in the chapter 11 to manage liquidity can help a company avoid a second trip to the courthouse.*

Conclusion

Although 2019 has seen a spike in Debtors filing for in-court protection a second time, this should not overshadow the core fact that the Bankruptcy Code requirements for feasibility are almost always met. And, generally, the Study shows that when Debtors have found themselves in bankruptcy again, the factors that caused the need for a second in-court restructuring often could be anticipated in the business plan confirmation. By paying special attention to six factors – achievable goals, pricing dynamics, customer concentration, the relevance of the operating model, the hangover effect and liquidity management – the risk of a Debtor needing a further restructuring can be minimized.

Chapter 22 filing trends – which largely tracked markets in the 2000s – have behaved differently since 2010 …



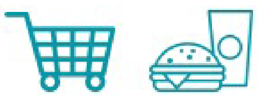
Sources: BankruptcyData, Bloomberg

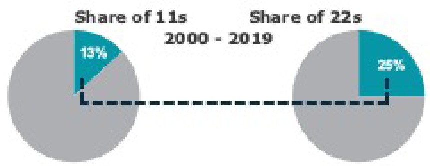
1

… and not all sectors have been impacted equally

- Perhaps unsurprisingly, repeat filers are more likely to come from industries that have been dealing with significant disruption
- Specifically, companies in the *retail / restaurant*, *energy*, and *tech / telecom* sectors are responsible for significantly more than their "fair share" of chapter 22 filings

Retail & Restaurant





- The ongoing disruption faced by retailers and restaurants have been well-documented
  - Online shopping options and reduced mall visitation
  - Competition from new business models including DTC, rental, and subscription
  - Increased prevalence and ease of mobile food ordering and delivery
- Also, lease-related provisions in the BK code typically compress time frames in these types of cases, exacerbating the problem

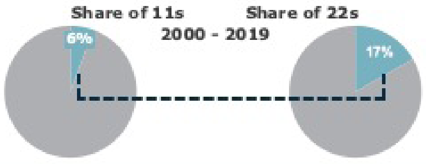
Source: BankruptcyData

2

… and not all sectors have been impacted equally (cont'd)

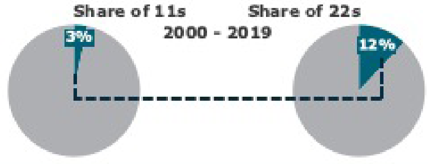
Energy

- Challenging environments in oil & gas and metals & mining have led to multiple repeat filings in energy
  - Knock-on effects of fracking technology
  - Expansion of renewables
  - Continued oil price volatility



Technology & Telecom

- Contending with a host of disruptive elements due to the rapid pace of technological change
  - "Cloud" impacts on data storage and enterprise software
  - "OTT" players cannibalizing messaging and voice revenues that telecoms have relied on



Source: BankruptcyData

Plan feasibility – An overview

Pursuant to Chapter 11 of the Bankruptcy Code, one of the many statutory requirements that a plan must satisfy in order to be confirmed is Section 1129(a)(11), also known as the 'feasibility' requirement.

This section requires a bankruptcy court to find that the debtor has a reasonable chance of surviving and remaining solvent once the plan is confirmed and consummated and the debtor emerges as a reorganized entity. The burden for establishing feasibility lies with the plan proponent.

Plan feasibility – An overview (cont'd)

Section 1129(a)(11) specifically provides that:

(a) The court shall confirm a plan only if all of the following requirements are met:

> … (11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed by the plan.
>
> 11 U.S.C. § 1129(a)(11).

Plan feasibility – An overview (cont'd)

General factors that courts use in assessing feasibility of a Chapter 11 plan include:

- The adequacy of the debtor's capital structure
- The debtor's earning power
- Economic conditions
- The ability of debtor's management and the probability of its continued management
- Other factors that will affect the successful operations of the debtor's business and ability to carry out the plan's provisions
- Timely adequate protection payments and other payments during the case

Plan feasibility – An overview (cont’d)

Persuasive evidence of feasibility can include:

- The company’s expected financial operations, including future cash flow, expected profitability and debt assumption
- The company’s future operations, taking into consideration any expected changes as a result of the confirmed plan or the market, such as increased revenue, a reduction in expenditures, a change in a product or service, the company’s competitive advantages and disadvantages
- *Chapter 11 plans that contain overly aggressive assumptions, unrealistic projections, and/or unreliable information will likely not satisfy the feasibility standard*

Plan feasibility – Caselaw

Paragon Offshore (Bankr. D. Del. No. 16-10386) (CSS) – Judge Sontchi denied confirmation and in his ruling examined the plan’s feasibility in detail. He concluded the plan proposed by the debtors, global providers of offshore drilling rigs, was not feasible because, among other things the debtors’ business plan was not reasonable and the debtor would be unable to refinance its debt upon maturity. Focusing on liquidity (as opposed to balance sheet solvency upon emergence), the court stated 'at the end of the day, these cases are all about liquidity.'

Plan feasibility – Caselaw (cont'd)

Friendship Dairies (Bankr. N.D. Texas 12-20405) (RLJ) – the court similarly denied confirmation after finding the plan was not feasible. The court highlighted the debtor's struggles during the case (failure to meet projections, adequate protection payment defaults, operational issues), coupled with insufficient liquidity and cash flow upon emergence to make plan payments in reaching its conclusion that the debtor essentially stumbled 'at the starting line.'

Plan feasibility – Specific factors that may impact analysis

In conducting a feasibility analysis, a judge can be influenced by a number of key factors related to a debtor's business and post-confirmation business plan, which can include, among others:

- **Exit Debt Maturity:** Regardless of whether exit debt financing is reinstated or consists of new money, a judge will be concerned about when that debt matures. What is the anticipated revenue and earnings trajectory of this business?
  - A judge will want to know that the debtor will have the ability to pay off such debt come maturity, or if it will have the means to refinance such debt at maturity.
  - This issue may be exacerbated if a debtor has multiple tranches of exit debt financing maturing at the same time or in rapid succession, or if many similarly-situated companies have debt also maturing at a similar time, causing concern for a potential credit crunch by likely lenders.
- **Exit Debt Commitment:** If a debtor needs to secure new money exit financing post-confirmation but pre-plan consummation, or if the chapter 11 plan calls for near-term post-confirmation refinancing of exit debt, a judge will want to ensure that either the debtor has investor commitments in place to secure or refinance such debt, or has a robust marketing plan in place to obtain the same.
- **Cash Liquidity:** Generally, the greater the cash liquidity a debtor has upon emergence, the more comfort a judge will have with respect to ensuring a debtor will be able to perform in the ordinary course of business post-confirmation.
- **Cash Flow:** Closely related to cash liquidity, if a debtor's business is cash-intensive, or if it has variable cash-flow issues (either in the ordinary course or due to the nature of the debtor's business) a judge may focus on the debtor's go-forward ability to satisfy its obligations in the ordinary course where it may experiences acute periods of either (i) diminished cash-inflows or (ii) extensive cash-outflows.

Plan feasibility – Specific factors that may impact analysis (cont'd)

- **State of the Industry:** A key factor that may weigh over a debtor's overall restructuring is the state of the industry in which a debtor operates.
  - If a debtor's industry is severely volatile or cyclical (commodities), going through a period of depressed pricing (such as oil & gas), or going through a period of extensive turnover or industry-wide upheaval (retail), a judge will want to be assured that a debtor's plan accounts for such industry-wide market factors such that the debtor can perform post-confirmation.
- **State of the Economy:** A judge will be concerned with the overall state of the economy.
  - As noted, stability and a debtor's ability to perform its obligations in the ordinary course post-petition is a key consideration for a bankruptcy judge in feasibility. If the market economy as a whole is stressed or struggling, a judge may want to be assured that a debtor's business plan can weather the effects of the down cycle
- **Third Party Approvals:** Whether a debtor's plan relies upon the success of potentially contingent or third-party actors that will not be received until post-confirmation may also weigh on a judge's mind in a feasibility analysis.
  - For example, if a plan calls for governmental approvals, or consummation of a purchase transaction (whether the debtor is the seller or the purchaser), the contingency risk of those conditions not being satisfied may impact a judge's overall feasibility analysis, particularly if the process for securing such conditions is not already in the works by the debtor.
  - For that reason, it is always good practice, where practicable, to secure or gain commitments of necessary third-party approvals before plan confirmation, to assuage a judge of concerns on this point.

Overview of the projections exhibit

- Goal is to allow readers of the disclosure statement to answer important questions about the reorganizing company:
  - What is the anticipated revenue and earnings trajectory of this business?
  - What will the reorganized company's leverage and working capital profile look like?
  - Will the company generate enough cash to service debt payments or other obligations?
- Because companies rarely share their long range plans, projections must "toe the line" between sharing too little or too much information
  - Too little detail makes it challenging for a user to make assessments on achievability
  - Too much detail puts sensitive information in the hands of the public, including competitors
- While a portion of today's panel will be dedicated to examining the "normal course" approach, the typical process is far from an afterthought
  - The long range plan is an integral part of most valuation exercises (needed to size distributable value) and informs views on debt capacity (needed to determine what "currency" creditors will receive – debt or equity)
  - Stakeholders often spend a large amount of time performing due diligence on a debtor's long range plan, and plan objectors will often focus on projection accuracy and achievability in their arguments
  - As a result, a large amount of time and energy is often dedicated to the development of a projection and projection exhibit, as illustrated on the following page

How Is Feasibility Typically Demonstrated?

Kodak example

Background / Level Setting

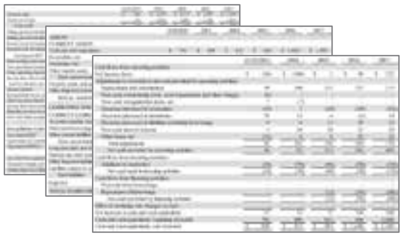
Purpose and Intended Use	Disclaimers
Basis of Presentation	List of Risk Factors

Forecasting Process Overview & Explanatory Bridge to Prior Versions

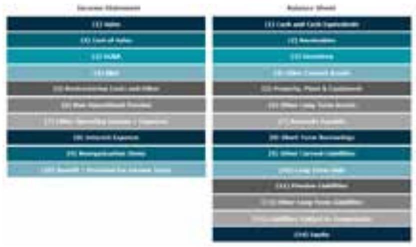
Other Common Elements

Pro Forma Balance Sheet

5 Year Projections For IS, BS, CF



Detailed Assumptions for Key Line Items



Sources & Uses

Kodak Example Totaled 15 Pages in Length (Not Uncommon)

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Red Flags and Suggested Best Practices

What are some of the red flags?

Antennae raising circumstances	*Related concerns*
1. History of missing guidance (for example, revenues, production levels, EPS)	• Why are these latest financial projections any more credible?
2. Recent and anticipated management and BOD changes	• Who's business plan is reflected?
3. Significant reinstatement of funded debt	• Has leverage been sufficiently reduced?
4. Major constituencies not part of deal	• Are financial projections 'massaged' to support the plan proponent(s') position(s)?
5. Exogenous industry risks • Consumer trends impacting retail businesses • Regulatory changes impacting healthcare sector • Commodity fluctuations impacting energy/metals • Feedstock supply, customer concentration, etc.	• Are the downside risks properly quantified?

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Incremental disclosures to assess feasibility

Qualitative

- Key drivers of risk and steps taken to mitigate both during Chapter 11 and post
- Process undertaken to prepare the disclosure statement projections including preparer(s) and qualifications. Identify differences, if any, with existing internal business plans
- History of meeting business plan projections

Quantitative

- Liquidity projections for 24 months post emergence (cash and borrowing capacity)
- EBITDA sensitivity analysis for key assumption (for example, same store sales, commodity pricing)
- Downside scenario financial projections showing impact on EBITDA, liquidity and financial covenant cushions
- Filing to date actual operating results vs budget

What can debtors do to further shore-up plan feasibility demonstration?

A debtor and its advisors can take a number of actions to shore-up the demonstration of plan feasibility.

- **Robust Business Plan Creation Process:** Create a process that bolsters a debtor's, its advisors', and the business plan's credibility. This can be done through a variety of methods, such as:
  - Having the business plan approved by an independent governing authority such as a duly formed restructuring committee.
  - Ensuring that the business plan is developed by management with proper involvement from the debtor's advisors
    - An additional measure could be having third-party industry experts independently verify a debtor's proposed business plan in accordance with appropriate industry standards.
    - This verification can take a number of forms, for example, focusing purely on the debtor's go-forward ability to perform, or comparing the debtor's business plan to other plans of similarly situated companies in the debtor's industry.
    - Independent verification can also be used to protect a debtor's business plan where the credibility of the business plan's proponents or creators has been previously called into question.
  - To the extent there is a marketing process required, ensuring such process is robust, with enough time to properly solicit third-party interest and engage with third-parties to determine whether a better third-party offer is available.
- **Reduce Contingency Risk:** Many of the concerns discussed herein relate to various contingencies inherent in a proposed plan (e.g. liquidity) or in the debtor's business environment (e.g. industry). Accordingly, another method of mitigating feasibility risks is to directly protect against the worst contingency risks that may present themselves before a judge.
  - This can include, among other things, (i) including a higher cash liquidity cushion, (ii) demonstrating feasibility through reliance on a lower projected commodity valuation, (iii) reducing debt capacity or debt service capacity, and (iv) spreading out or reducing the timing of debt repayment or refinancing.

Suggested best practices?

1. Establish minimum guidelines for disclosure statement financial projections such as:
   - Three year balance sheet, income statement and cash flow projections
   - 24 month liquidity projections
   - Key driver sensitivity analysis
   - Downside scenario(s) showing impact on EBITDA, liquidity and financial covenant cushions
   - History of meeting financial projections
2. Affirmative statement by current board of directors regarding reasonableness of projections
3. Feasibility assessment should be increased to three years
4. Accelerate feasibility testimony to disclosure statement hearing

The Quid Pro Quo of Chapter 22

Do the Benefits Outweigh the Costs?

BY MELISSA KIBLER KNOLL, CTP, SENIOR MANAGING DIRECTOR & K. BRAD HAYES, SENIOR VICE PRESIDENT, MESIROW FINANCIAL CONSULTING, LLC

HOT TOPICS

Bankruptcy neophytes frantically scouring Title 11 of the United States Code to locate "Chapter 22" should search no more—it does not exist. However, according to New Generation Research, Inc., that has not stopped more than 200 companies since 1978 from filing Chapter 22, the colloquial term used by many restructuring professionals to describe a debtor's second attempt at Chapter 11 reorganization. Some have filed "Chapter 33" in a third attempt at rehabilitation, and one company, Trans Texas Gas Corporation, even managed a "Chapter 44," filing first in 1974 under the Bankruptcy Act and then again in 1983, 1999, and 2002 under the Bankruptcy Code.

Chapter 11 provides an orderly mechanism for the reorganization of a troubled company's financial and operational affairs—in effect, a second chance. To facilitate this objective, the code modifies certain rights that would otherwise exist outside of bankruptcy, balanced by protections through both bankruptcy and applicable non-bankruptcy law, to effectuate potential benefit to society and constituents.

When it passed the Bankruptcy Reform Act of 1978, Congress said that "[t]he purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors and produce a return for its stockholders. The premise...is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap....If the business can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than liquidate, because it preserves jobs and assets." (H.R. Rep. No. 595, reprinted in 1978 U.S.C.C.A.N. 5963, 6179).

However, the idea that the opportunity to reorganize and continue as a going concern is a preferable option is not universal; many other countries' insolvency laws historically and currently favor receivership or liquidation, similar to Chapter 7 under the Bankruptcy Code. The ability to reorganize under Chapter 11 is perhaps the most distinguishing feature separating U.S. bankruptcy law from international standards governing the orderly resolution of insolvent organizations. As a result, the U.S. has been viewed as the leader of the debtor-driven model that other countries have recently begun to emulate in various ways, shapes, and forms.

But what happens when a debtor fails to fully rehabilitate under Chapter 11 and finds itself on the brink of Chapter 22? What are the benefits of allowing a second, third, or fourth chance at reorganization? Is the need to seek additional protection a failure of Chapter 11 or just another step toward recovery? What are the costs of Chapter 22? This article first examines common paths to Chapter 22 and whether multiple filings can be reliably predicted. It then considers the quid pro quo—what do constituents get (i.e., the benefits) in exchange for what they give (i.e., the costs) when providing multiple opportunities for a company to reorganize under the code?

Common Paths to Chapter 22

Bankruptcy Code Section 1129(a) (11) requires a plan of reorganization to be feasible. Under the aptly named feasibility test, a plan proponent must prove, and the court must find, that the plan is not likely to be followed by liquidation or the need for further financial reorganization unless proposed in the plan. What, then, results in post-emergence failure to meet this tenet of the code in repeat bankruptcy filings?

Causes of financial distress leading to bankruptcy, Chapter 11 or otherwise, include both internal and external drivers. Internal drivers often stem from excessive financial leverage, poor management, and/or operational shortcomings; external drivers can involve secular market declines, technological change, increased competition, and economic downturns.

In addition, based on filings from 2009 to 2012, certain industries comprise a disproportionate number of filings and may be inherently prone to Chapter 22, as illustrated in **Figure 1** (page 10). However, the two most common themes persistent among Chapter 22 filers appear to be (a) excessive leverage and (b) persistent operational problems post-emergence.

When a debtor fails to deleverage sufficiently in bankruptcy, the "rehabilitated" company is far more susceptible to other internal and external drivers of financial distress. But why do debtors fail to right-size their capital structures when given the chance? One explanation may be the varied financial interests of parties pushing leverage to levels unsustainable in the long term. The debtor is forced to accept unfavorable compromises in negotiating a plan of reorganization with creditors jockeying to maintain and improve their positions in the capital structure.

As a result, while the debtor's initial plan proposal may have contemplated "reasonable" leverage metrics and a debt-to-equity conversion, creditor negotiations may end with a highly speculative financial structure, consistent with a "junk" issuer, upon emergence. Any shortfall in the company's business plan, whether due to internal or external drivers, may tilt that highly speculative credit into default post-emergence and necessitate a second reorganization.

The second common factor leading to Chapter 22, the failure to address operational problems, exacerbates issues arising from excessive leverage. While certain operational problems such as continued industry or secular decline may be difficult to address, few are irreparable. Failure to address weak management teams, shed underperforming businesses and/or products, or achieve necessary labor or cost savings ultimately harms all stakeholders.

Two relatively recent developments—the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) and the increased use of prepackaged and prenegotiated bankruptcies, known as prepacks—potentially impair a company's ability to address operational problems during the Chapter 11 process.

For example, BAPCPA shortened both the period in which a debtor has the exclusive right to file a plan of reorganization to no more than 18 months and the deadline for assuming nonresidential real estate leases, which now is not more than 210 days. One

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result of these and other provisions is that certain debtors, particularly large debtors, are left with too little time to identify and address operational problems adequately prior to emergence.

The increased prevalence of prepacks may be due in part to BAPCPA, in combination with other market factors. While prepacks are not new, some believe that the reduced time frames for Chapter 11 processes, combined with increased administrative costs, have encouraged more management teams to seek prepacks. The quick exit from bankruptcy proceedings and the need to resolve difficult issues in advance provide management less opportunity to address operational problems.

For example, labor and other contract and lease negotiations are time-consuming and complex, and significant modifications may not be achievable in a prepack. These issues may cause management to focus primarily on balance sheet solutions. Only time will tell whether these factors will in turn result in a significant change in the landscape for Chapter 22.

Is Chapter 22 Predictable?

One debtor, not atypical of an emerging company, recently confirmed its Chapter 11 plan and received a B- corporate rating, the lowest tranche of "highly speculative" ratings, and a CCC+ bank loan rating, denoting "substantial risk," in an industry prone to distress. While such post-emergence ratings are not unusual, it would hardly be shocking if this reorganized debtor finds its way onto the list of Chapter 33s since this was the company's second trip through Chapter 11. Despite all of that, Standard & Poor's (S&P) *still* assigned a "stable" outlook to this entity based on the company's "more manageable capital structure."

While no company emerges from Chapter 11 intending to reenter bankruptcy, excessive leverage and failure to address operational problems may increase that likelihood. But what amount of debt is excessive and what operational shortcomings must be addressed to provide a trier of fact and other stakeholders a reasonable basis to conclude that a plan is feasible?

Professor Edward I. Altman of New York University's Stern School of Business published a study in the *Journal of Corporate Renewal* (January/February 2010) examining the ability of his well-known Z-Scores to predict the likelihood that a debtor will file Chapter 22. Z-Scores are financial tools used to assess the creditworthiness of companies. Variants of the Z-Score, designed originally for manufacturing companies, include the Z'-Score for private companies and Z"-Score for non-manufacturing companies.

Altman's Z-Score weights various financial ratios involving liquidity, profitability, operating efficiency, asset turnover, and market value indications to quantify a firm's health. Generally speaking, the lower the score, the higher the odds are that a company will file for bankruptcy. Scores higher than 3.0 are considered healthy, while scores below 1.8 are considered in the distressed zone; scores in between are considered to be in a grey area.

Altman discovered that, based on his sample and analysis, the average post-emergence Z"-Score of Chapter 22 filers was 2.67 (median of 3.05), considerably lower than other Chapter 11 filers, with their average Z"-Score of 4.73 (median of 4.38). Altman concluded that companies that eventually filed a second bankruptcy had significantly worse financial profiles immediately following

Figure 1

Chapter 22s and 33s by Industry (2009-YTD March 2012; years listed are for subsequent filings)

Automotive Hayes Lemmerz International, Inc. (2009) Holley Performance Products Inc. (2009) J.L. French Automotive Castings, Inc. (2009) Meridian Automotive Systems, Inc. (2009)	**Oil & Gas** Eagle Geophysical, Inc. (2009)
Aviation ATA Airlines (Global Aviation Holdings Inc.) (2012)	**Other** Hines Nurseries (2010)
Banking & Finance FIRSTPLUS Financial Group, Inc. (2009)	**Packaging & Paper** Constar International Inc. (2011) Pilant Corporation (2009)
Computers & Software Silicon Graphics, Inc. (2009)	**Publishing** Vertis Holdings, Inc. (2010)
Energy Composite Technology Corporation (2011)	**Restaurant** Buffets Restaurants Holdings, Inc. (2012)
Entertainment Movie Gallery, Inc. (2010)	**Retail** Eddie Bauer Holdings, Inc. (2009) Filene's Basement, Inc. (2009, 2011) Fortunoff Holdings, LLC (2009) Goody's, LLC (2009) Loehmann's Holdings, Inc. (2010) Ultimate Electronics, Inc. (2011) Ultra Stores, Inc. (2009)
Food, Beverage & Tobacco Hostess Brands, Inc. (2012)	
Health Care & Medical InSight Health Services Holdings Corp. (2010) Tetragenex Pharmaceuticals, Inc. (2009, 2010)	**Supermarket** Bruno's Supermarkets, LLC (2009) The Penn Traffic Company (2009)
Manufacturing Davi Skin, Inc. (2010) Foamex International Inc. (2009) Fountain Powerboat Industries, Inc. (2012) Moll Industries, Inc. (2010) Neenah Enterprises, Inc. (2010) SKYE International, Inc. (2011) TVI Corporation (2009)	**Telecommunications** eNucleus, Inc. (2009) Satelites Mexicanos, S.A. de C.V. (2011) TerreStar Corporation (2011) **Transportation** TBS Shipping International (2012) Trico Marine Services, Inc. (2010)

Source: New Generation Research, Inc.

emergence than did companies that remained going concerns for at least five years post-emergence.

Additional quantifiable data, including comparisons of common liquidity measures; leverage metrics, such as debt-to-earnings, debt-to-equity, total liabilities-to-earnings, total liabilities-to-total assets, interest coverage, and fixed charge coverage; and industry averages provide some gauge of a debtor's leverage prior to plan confirmation. While the adequacy of operational changes may be more difficult to measure, benchmarking labor costs, operating costs, margins, and other profitability metrics may provide some insight into the depth and breadth of management's restructuring actions—or lack of them. The achievability of a debtor's projections, which incorporate all of these factors, is clearly central to assessing the future viability of the enterprise.

No advisor, stakeholder, debtor, or court has a crystal ball capable of definitively predicting whether a plan of reorganization will be successful or if a subsequent Chapter 11 filing is inevitable. Indeed, courts are unlikely to raise the issue of feasibility *sua sponte* and override the business judgment of the parties with a financial stake in the restructuring if no objections are raised. Unforeseen post-emergence developments may also be to blame for certain Chapter 22 filings.

However, it is folly to believe that certain subsequent filings could not have been at least suspected, if not anticipated, and action taken to reduce, but not eliminate, the probability of occurrence. **Figure 2** (page 12) illustrates selected data from certain recent Chapter 22 filings available at or about the time of their preceding Chapter 11 emergence. With median Z-Scores and total liabilities-to-total assets of 1.30 and 84.9 percent, respectively, is it surprising that these companies subsequently refiled Chapter 11?

A Balanced Approach

In Chapter 11, a debtor is granted certain rights and protections, such as the automatic stay and the exclusive right to propose a plan of reorganization. Are these and other rights and protections too costly to warrant a second chance at rehabilitation, or are the offsetting rights and protections afforded a debtor's stakeholders in Chapter 11 sufficient to protect them in a Chapter 22? Two provisions applying to all classes of creditors and interest holders seek to balance the rights of the debtor and its stakeholders—the best interests test and the absolute priority rule.

First, Section 1129(a)(7) of the code requires that a confirmable Chapter 11 plan provide that each class of claims or interests receive or retain not less than the amount they would have received in liquidation under Chapter 7. Commonly referred to as the "best interests test," this safety net considers whether stakeholders' anticipated recoveries through the reorganization process are equal to or exceed the amounts projected in a hypothetical liquidation.

Additionally, Section 1129(b)(2) of the code requires that a plan be "fair and equitable" and incorporates provisions governing the consideration to be distributed to different classes of claims and interests. Embodied within these provisions is the absolute priority rule, which ensures that no junior claimant will receive any recovery unless more

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senior claimants are paid in full or they agree to such treatment.

Furthermore, stakeholders receive detailed financial disclosures and are provided the right to vote if their claims are impaired under the plan of reorganization. These provisions operate in conjunction with other sections of the code and applicable non-bankruptcy law to facilitate the reorganization of the debtor while protecting the basic rights of the creditors and other stakeholders.

Secured creditors are enjoined by the automatic stay from foreclosing on their collateral or otherwise collecting or attempting to collect amounts due, but under Section 361 of the code they may seek adequate protection to guard against any diminution in the value of their collateral. Furthermore, many current debtor-in-possession (DIP) financing arrangements include a "roll-up" of prepetition debt, under which the prepetition balance is "repaid" by the DIP facility. This effectively converts the prepetition debt to the same super-priority status as incremental post-petition advances.

While employees are often asked to take substantial wage reductions, accept changes to long-established work rules (for unionized workforces), and bear sweeping layoffs, such requests are often at the heart of operational restructuring initiatives necessary to prevent or at least reduce the risk of a subsequent filing. Compared to the alternative of liquidation, in which all jobs and benefits are likely lost, labor concessions necessary to improve long-term corporate health, continue employment of at least some staff, and potentially maintain retiree benefits may be a reasonable exchange.

Furthermore, current and former employees are afforded numerous protections under both bankruptcy and applicable non-bankruptcy law. Section 1113 of the code requires, *inter alia*, good-faith negotiations and exchange of information with collective bargaining units, while Section 1114 imposes similar safeguards in connection with the modification of retiree benefits. In addition, non-bankruptcy labor and benefits protections under the Worker Adjustment and Retraining Notification Act of 1988, the Employee Retirement Income Security Act of 1974, and the related Pension Benefit Guaranty Corporation provisions remain in force and serve to provide additional safety nets for employee interests.

For vendors and contract parties, a primary consideration is that Chapter 11 provides an opportunity to continue a customer (or supplier) relationship, presumably with a stronger, healthier post-emergence entity. While debtors can reject unexpired leases and other executory contracts under Section 365, the code also provides for breach of contract damages for such parties, with certain limits, such as those under Section 502(b)(6) for nonresidential real estate.

Implicitly, Congress concluded that at least some societal benefit exists in rehabilitation and that access to multiple Chapter 11 filings warrants taxpayer support. This support traditionally has been indirect, in the form of special tax benefits for reorganizing companies or payment extensions for prepetition taxes over five years. In return, governments receive continued income, property, and other tax revenues. Less obvious may be the reduced strain on social welfare and safety net programs

Figure 2

Chapter 22s and 33s Upon First Chapter 11 Emergence

Debtor[1]	Effective Date	Z-Score[2]	Total Liab./ Total Assets[2]	Total Debt/ EBITDA[2]
Composite Tech. Company	11/18/05	-13.81	225.90%	n/a
Constar International Inc.	6/2/09	2.24	77.70%	1.9x
Foamex LP	2/12/07	2.05	147.00%	5.9x
Hayes Lemmerz	6/3/03	1.3	74.50%	3.2x
Insight Health Servics Corp.	8/1/07	0.82	92.20%	5.5x
Loemann's Holdings Inc.	10/31/00	3.7	59.10%	0.9x
Movie Gallery Inc.	5/20/08	-1.71	233.80%	n/a
Neenah Enterprises Inc.	10/8/03	0.93	107.30%	8.9x
Penn Traffic Co.	4/13/05	4.82	63.60%	1.6x
Pliant Corp.	7/19/06	1.06	118.50%	7.7x
Satelites Mexicanos	12/4/06	n/a	92.20%	6.3x
Silicon Graphics	10/17/06	8.02	18.70%	n/a
Terrestar Corporation	5/1/02	0.65	21.90%	n/a
Trico Marine	3/15/05	2.61	67.00%	2.9x
Median		**1.3**	**84.90%**	**4.4x**

Source: Capital IQ; New Generation Research, Inc.

[1]Includes debtors that reentered bankruptcy from 2009 to March 2012
[2]Based on financial information available as of or about the effective date of emergence. Includes only companies that were public upon emergnece

because continued employment leads to fewer welfare and aid recipients, as well as certain intangible benefits.

Each of these provisions balances the costs and benefits in Chapter 11, which apply equally in Chapter 22 or beyond. However, Chapter 22 is not without its costs. There is the obvious administrative expense of Chapter 11, which is not insignificant. One can view this cost as an investment that should generate a return, albeit one that is difficult to measure. The administrative cost of a second Chapter 11 is more questionable, especially when it is aimed at achieving the goals of the first.

Bankruptcy is also fraught with uncertainty and risk to both the business and the reorganization; what could have been done once may not be possible the second time around. Everyone stands to lose if the company continues to decline and does not arrest the deterioration that caused the original and subsequent filings. In that circumstance, one could argue that parties in interest would have been better off liquidating the company and taking their money and going home in the first place.

However, many parties still benefit in the interim, even if the result is a second bankruptcy filing—employees maintain jobs, retirees retain benefits, vendors make profits on sales, and financial creditors receive interest. And in the quest to achieve the hoped for benefits of reorganization, the only sure way to fail is never to try.

Sharing the Pain

There are benefits to Chapter 11, regardless of a debtor's past transgressions and previous filings. The Bankruptcy Code is a rehabilitation framework that provides parties in interest an opportunity to negotiate under the protections of bankruptcy and applicable non-bankruptcy law to preserve going concern value at the potential risk of eroding liquidation value.

But Chapter 11 is not carte blanche—it requires careful assessment of the likelihood of success to position a company to realize the incremental value that may be achieved. Bankruptcy relies on a shared-pain concept to achieve the greater good, and if there is not sufficient compromise by the parties, the goals of Chapter 11 will not be achieved. As previously discussed, the code provides the debtor and the court certain powers to force that shared pain. In exchange, it requires, among other things, that a plan be feasible, which in turn necessitates transparency and sufficient information about the likelihood of a successful reorganization under a range of potential future circumstances.

Finally, the reality is that Chapter 11 is ever-changing as Congress amends the code, case law develops, and markets evolve. Remaining open to reexamining the code's effectiveness in achieving its framers' objectives and addressing current business challenges is essential. In that regard, the American Bankruptcy Institute (ABI) last year announced the formation of the Commission to Study the Reform of Chapter 11. Comprised of many of the stalwarts of bankruptcy theory and practice, the commission's mission statement is as follows:

"In light of the expansion of the use of secured credit, the growth of distressed-debt markets and other externalities that have affected the effectiveness of the

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current Bankruptcy Code, the [c]ommission will study and propose reforms to Chapter 11 and related statutory provisions that will better balance the goals of effectuating the effective reorganization of business debtors—with the attendant preservation and expansion of jobs—and the maximization and realization of asset values for all creditors and stakeholders."

The commission will collect and analyze data, case law, and commentary on 13 separate study topics, which range from financial and governance matters to all aspects of the reorganization plan process. The commission's outreach methods will include public hearings around the country, and a website has been established at commission.abi.org. Funded by ABI's endowment and general funds, the commission will issue a final report in 2014.

As part of this process, many of the fundamental purposes of Chapter 11 and potential drivers of Chapter 22 will be addressed, including the effects of BAPCPA and prepacks.

The commission's activities and recommendations are expected to form the basis of a more efficient and effective process for addressing and resolving today's business financial distress in a manner that maintains the flexibility and balance that Chapter 11 has achieved but perhaps also strengthens it in ways that will lessen the likelihood and cost of Chapter 22 and subsequent filings.

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Hayes provides financial advisory services, including financial and operational restructurings, turnaround management, and M&A transaction advisory services in a wide range of industries. He holds an MBA from Northwestern University's Kellogg School of Management and a bachelor's degree from Indiana University.