International Insolvency Institute
8th Annual International Insolvency Conference
June 9-10, 2008

Prepackaged Chapter 11 Case Considerations and Techniques

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I. INTRODUCTION

The decision to commence a case under chapter 11 of the Bankruptcy Code has always been very difficult to make, notwithstanding the fact that many of our largest and most venerable institutions have chosen that path.[1] The decision is difficult for many reasons, not least of which is the fear of the unknown: chapter 11 can result in a loss of control by management, a change in management, a decline in business prospects, or even liquidation of the firm.

The principal method to reduce these risks significantly and enhance the chances of exiting chapter 11 is for a debtor to reach an agreement with its principal creditors as to the terms of a plan of reorganization and to commence a case with the votes necessary to confirm a chapter 11 plan already in hand. A myriad of "prepackaged chapter 11 case" options exist, but each seeks to minimize the time that the debtor remains or operates in chapter 11. By completing or nearly completing the time-consuming task of negotiating and gaining acceptances to a plan of reorganization prior to the filing of the chapter 11 petition, a debtor and its creditors can hasten the exit from chapter 11. Of equal significance is the fact that the prepackaged chapter 11 process enables the debtor to exercise greater control over the reorganization process.

Although the prepackaged chapter 11 case may be as old as corporate reorganization law itself, its attractiveness was rediscovered in the late 1980s.[2] The use of this format peaked in the early 1990s, thereby giving the bar and bench the opportunity to establish and refine the governing principles for the expeditious processing of chapter 11 cases. Towards the end of the 1990s, however, the number of prepackaged cases fell and has since remained at a stable level.[3]

Several factors may have contributed to the decline of prepackaged chapter 11 cases. First, a number of entities that had emerged from chapter 11 subsequently found themselves filing for chapter 11 protection again (commonly referred to as "chapter 22"

[1] To name a few, chapter 11 has been used by Global Crossing Ltd., Enron Corp., WorldCom, Inc., UAL Corp., Delta Air Lines Inc., Northwest Airlines Corp., Delphi Corp., Parmalat USA Corp., Loral Space & Communications Ltd., Bethlehem Steel Corp., R.H. Macy & Co., Inc., Federated Department Stores, Inc., Ames Department Stores, Inc., Texaco Inc., WestPoint Stevens Inc., and Genesis Health Ventures, Inc.

[2] The chapter 11 case of *Crystal Oil* generally is recognized as the first prepackaged bankruptcy under the Bankruptcy Code of any significant size. *In re* Crystal Oil Co., No. 586-02834 (Bankr. W.D. La. 1986). *Crystal Oil* was followed by *In re* Anglo Energy, Inc., No. 88-B-10360 (BRL) (Bankr. S.D.N.Y. 1988), *In re* Circle Express, Inc., No. 90-07980 (RLB) (Bankr. D. Ind. 1990); *In re* La Salle Energy Corp., No. 90-05508-H3-11 (LC) (Bankr. S.D.Tex. 1990), *In re* Southland Corp., No. 390-37119-11 (Bankr. N.D. Tex. 1990), *In re* JPS Textile Group, Inc., No. 91-B-10546 (JAG) (Bankr. S.D.N.Y. 1991), *In re* MB Holdings, Inc., No. 91-B-15617 (BRL) (Bankr. S.D.N.Y. 1992), and *In re* Memorex Telex N.V. & Memorex Telex Corp., No. 92-8 (Bankr. D. Del. 1992).

[3] THE 2004 BANKRUPTCY YEARBOOK & ALMANAC 162 (Christopher M. McHugh & Thomas A. Sawyer eds., 2004) (citing statistic that prepackaged cases account for approximately six percent of all chapter 11 filings).

filings), likely resulting from the conversion of an insufficient amount of debt to equity during the initial chapter 11 filing. Second, prepackaged chapter 11 cases work best when the public debt has been issued by a holding company, while business operations are at the subsidiary level. However, many chapter 11 cases filed recently involve companies where significant operations take place at the parent company level. Lastly, the average duration of a chapter 11 case has steadily decreased over the years, thereby diminishing the benefits generally attributed to the expeditious nature of a prepackaged case.[4]

II. HISTORIC ANTECEDENTS

The prepackaged chapter 11 case has its roots in the late nineteenth century equity receivership practice.[5] There, in connection with a restructuring and the commencement of an equity receivership in the federal court, a "protective committee" of bondholders or similar creditors of a financially distressed enterprise often would be formed. Individual bondholders would be asked to deposit their bonds with the protective committee under instruments known as "deposit agreements." The protective committee would then structure a plan of reorganization, and submit it to a court for confirmation in an expedited equity receivership proceeding.[6]

Responding to charges that protective committees were being abused by insiders, reorganization managers, and senior creditors to the detriment of public bondholders,[7] Congress enacted as part of the Chandler Act in 1938[8] two separate forms of bankruptcy reorganization. Chapter X banned the solicitation of plan acceptances prior to the commencement of a reorganization case. Chapter XI, which was intended to be used only for the arrangement of unsecured debt and primarily for small, nonpublic businesses,

[4] *See* Symposium, *Resolved: The 1978 Bankruptcy Code Has Been a Success (A Debate)*, 12 AM. BANKR. INST. L. REV. 273, 276 (2004) (arguing that in recent years, the average duration of large chapter 11 cases is comparable to the aggregate time spent negotiating, filing, and confirming a prepackaged or prenegotiated chapter 11 plan); Joseph A. Guzinski, *Response: Small Business Reorganizations and the SABRE Proposals*, 7 FORDHAM J. CORP. & FIN. L. 295, 296 (2002) (noting that "[d]ata from the past decade demonstrate that the average time per case spent in Chapter 11 has consistently declined").

[5] Until 1933, corporate reorganization involving secured debt was generally accomplished through the nonstatutory mechanism of the federal equity receivership. *See* SECURITIES EXCHANGE COMMISSION, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES 10–60 (1940).

[6] *See* Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 21-23 (1995).

[7] For a discussion of some of these defects, see Jonathan Hicks, *Foxes Guarding the Henhouse: The Modern Best Interests of Creditors Test in Chapter 11 Reorganizations*, 5 NEV. L.J. 820, 826 (2005); Jacob Trieber, *The Abuses of Receiverships*, 19 YALE L.J. 275, 276-77 (1910).

[8] *See* Law of June 22, 1938, ch. 575, 52 Stat. 840 (repealed 1978).

authorized the solicitations of acceptances prior to a bankruptcy case, as long as the solicitation complied with applicable nonbankruptcy law.[9]

When Congress overhauled the bankruptcy system in 1978 and consolidated reorganization provisions into one basic chapter, *i.e.*, chapter 11, it abandoned the earlier prohibition against prepackaged plans, and made explicit provision in § 1126 of the Bankruptcy Code for prepetition solicitations of votes on chapter 11 plans of reorganization.[10]

III. POLICY CONSIDERATIONS

In formulating the Bankruptcy Code in 1978, Congress made clear that it wished to promote consensual arrangements between creditors and debtors. For example, the Bankruptcy Code includes a provision that allows the court to refrain from exercising jurisdiction over a voluntary or involuntary chapter 11 case if "the interests of creditors and the debtor would be better served."[11] Thus, a court may decide to abstain from exercising jurisdiction if a small group of creditors is attempting to disrupt the efforts of a debtor and its principal creditors from completing a consensual out-of-court restructuring or negotiation.[12] Similarly, the court may abstain if a debtor attempts to use chapter 11 to renegotiate an out-of-court restructuring to which it has recently agreed.[13]

Congress recognized that encouraging prepackaged chapter 11 cases could produce benefits similar to out-of-court restructurings.[14] Accordingly, it incorporated several provisions into the Bankruptcy Code to promote the process. For example, an ad

[9] *See* S. REP.NO. 95-989, at 122 (1978).

[10] *See* 11 U.S.C. § 1126(b).

[11] *See id.* § 305(a).

[12] The legislative history of this provision indicates that Congress recognized that there would be situations when the "less expensive out-of-court workout may better serve the interests of the case." *See* H.R. REP.NO. 95-595, at 325 (1977); *see also In re* Aerovias Nacionales, 303 B.R. 1, 10 n.11 (2003) (same).

[13] *See In re* Colonial Ford, Inc., 24 B.R. 1014, 1015–16 (Bankr. D. Utah 1982) ("Congress designed the Code, in large measure, to encourage workouts in the first instance, with refuge to bankruptcy as a last resort."); *see* LTV Corp. v. Valley Fidelity Bank & Trust Co. (*In re* Chateaugay Corp.), 961 F.2d 378, 382 (2d Cir. 1992) (citing *id.*).

[14] The legislative history states:

> In this context, the new chapter 11 deletes archaic rules contained in certain chapters of present law such as the requirement of an approval hearing and the prohibition of prepetition solicitation. Such requirements were written in an age before the enactment of the Trust Indenture Act and the development of securities laws had occurred. The benefits of these provisions have long been outlived but the detriment of the provisions served to frustrate and delay effective reorganization in those chapters of the Bankruptcy Act in which such provisions applied. Chapter 11 thus represents a much needed revision of reorganization laws.

124 CONG. REC. S17, 417 (1977).

hoc prepetition committee may be appointed as a statutory creditors' committee,[15] votes solicited prior to the commencement of a chapter 11 case may be counted for purposes of confirmation,[16] and chapter 11 plans may be filed with the debtor's petition.[17] In addition, Federal Rule of Bankruptcy Procedure 3018(b) makes express provision for voting on a plan of reorganization prior to the commencement of the case.

IV. BENEFITS OF PREPACKAGED CASES

A. RETENTION OF CONTROL

From the perspective of the debtor/borrower, one of the unfortunate aspects of chapter 11 is the potential for management or the current board of directors to lose control of the restructuring process or of control of the company itself.[18] Loss of control can come in many forms. For example, the debtor initially has the exclusive right to file and seek confirmation of a plan of reorganization.[19] Once that exclusive right expires, any party in interest may file a plan. Although through the early years of the Bankruptcy Code, creditors rarely took advantage of this opportunity, the level of sophistication of creditors has increased dramatically in recent years. Moreover, under the 2005 Amendments, which generally went into effect on October 17, 2005, the debtor's exclusive right to file a plan may not be extended beyond eighteen months after the date on which the debtor filed its petition for chapter 11 relief. Loss of control also can occur when creditors pressure the debtor's board of directors to replace key management or retain a "chief restructuring officer."[20] Although no section of the Bankruptcy Code requires such action, debtors often need the good will of large creditors in order to formulate a chapter 11 plan or to obtain post-petition financing. In more extreme circumstances, creditors may seek the appointment of a trustee.[21] The appointment of a trustee, though relatively rare, would entirely supplant the board of directors.[22]

[15] *See* 11 U.S.C. § 1102(b)(1).

[16] *See id.* § 1126(b).

[17] *See id.* § 1121(a).

[18] Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 610-11 (1993) (revealing changes in management in approximately 70% of the chapter 11 cases studied and concluding that "[c]hanges in control are regular occurrences" for companies in chapter 11).

[19] *See* 11 U.S.C. § 1121(b).

[20] *See* Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 186-87 (2004) (noting that the appointment of a chief restructuring officer often "takes away the decision making power of the debtor in possession and transfers control of the administration of a reorganization in or out of Chapter 11 to third parties other than the debtor").

[21] *See* 11 U.S.C. § 1104 (on the request of a party in interest, after notice and a hearing, a bankruptcy court may order the appointment of a trustee "for cause, including fraud, dishonestly, incompetence, or gross

Loss of control is not likely to occur in a prepackaged chapter 11 case for a variety of reasons. For example, as described below, prepackaged cases are almost always more expeditious than other chapter 11 cases, which leaves less time in chapter 11 for things to go wrong. Moreover, the debtor has reached agreement with all or almost all significant creditor groups. Therefore, the pressures of the negotiating process are notably absent by the time the company commences its chapter 11 case.

B. LESS EFFECT ON THE BUSINESS

It is almost universal that management believes that the commencement of a chapter 11 case will adversely affect the company's business operations. Management fears that customers will not want to deal with a company in chapter 11 and vendors will not ship critical supplies. Most companies that have used chapter 11, and importantly, survive the first three to four months, have found that bankruptcy does not necessarily interfere with business operations. In fact, bankruptcy can add stability to the business by, for example, significantly increasing a debtor's liquidity. However, some companies do not do well in chapter 11.[23] By dramatically reducing the amount of time in chapter 11, a prepackaged chapter 11 case tends to reduce both the perceived and actual risk to the business.

C. MORE EXPEDITIOUS REHABILITATION

Chapter 11 is especially good at two things: providing a protected environment to make significant operational changes[24] and revising a company's capital structure. For

mismanagement of the affairs of the debtor by current management" or if the appointment is in the best interests of creditors and the estate).

[22] *See In re* Texasoil Enters., 296 B.R. 431, 435 (Bankr. N.D. Tex. 2003) (noting that the appointment of a trustee is "draconian and correspondingly rare"); *see generally* Glenda M. Raborn, *Setting the Standards for Appointment of a Chapter 11 Trustee Under § 1104(a)(1) of the Bankruptcy Code: Can a Debtor Cooperative Remain in Possession?*, 18 MISS. C.L. REV. 509, 512, 526 (1998) (noting, historically, that the appointment of a trustee resulted in the displacement and unseating of management and further noting an "overriding theme in the Code to displace the debtor where the viability of the business is threatened or when the debtor is failing to preserve the organization's assets for the benefit of its creditors").

[23] *See* Miller & Waisman, *supra* note 21, at 187-88 (describing Winstar Communications, Inc.'s unsuccessful chapter 11 case, which was converted to a chapter 7 liquidation due to, among other things, Winstar's fatally flawed business plan); *see also* Ann H. Spiotto, *The Ultimate Downside of Outsourcing: Bankruptcy of the Service Provider*, 11 AM. BANKR. INST. L. REV. 47, 61 (2003) ("it must be emphasized that not every chapter 11 reorganization is successful – many cases originally filed under chapter 11 are converted to chapter 7 and/or end with the sale or liquidation of the business"); Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231 (2001).

[24] *See* 11 U.S.C. § 362 (applying the automatic stay, which enjoins the commencement or continuation of virtually all acts or actions against the debtor and to recover property of the estate); *id.* § 363 (governing the postpetition use, lease or sale of property of the estate); *id.* § 364 (authorizing the debtor to obtain credit and incur debt postpetition); *id.* § 365 (authorizing the assumption or rejection of executory leases and unexpired nonresidential real estate leases).

those companies that do not need to make operational changes (or that have already taken any needed steps), a prepackaged case offers an opportunity to reduce the time in bankruptcy. The time spent under the aegis of the bankruptcy court can be quite short because the only remaining task of significance is the approval of the disclosure statement and confirmation of the plan of reorganization.[25] At the time a prepackaged case is commenced, the debtor can report to its suppliers and customers that the ultimate outcome—a confirmed plan of reorganization—is more or less assured, thereby ameliorating the problem of uncertainty. Moreover, trade creditors, which have come to expect favorable treatment in prepackaged cases, often are less concerned about the prospect of such a case.[26] In addition, outside of the chapter 11 arena, there is no need to obtain court approval for the myriad of transactions that may be considered to be outside the ordinary course of business.[27] Finally, a prepackaged case usually is less contentious than a traditional case, giving rise to fewer negative news reports concerning the debtor's prospects and outlook.[28]

Of course, the use of a prepackaged plan does not necessarily insure a *total* restructuring period that is any shorter than what may occur in a traditional chapter 11 case.[29] Negotiations leading up to a prepackaged filing can take many months, as in the 1999 case *In re Zenith Electronics Corp.*,[30] where initial negotiations commenced more than a year before the filing of the petition. Moreover, prefiling negotiations can bog down indefinitely without a supervising bankruptcy court to assist and influence the

[25] Prepackaged cases have lasted less than thirty days, although forty-five to ninety days is more typical. *See* John J. McConnell et al., *Prepacks as a Mechanism for Resolving Financial Distress: The Evidence*, 8 J. APP. CORP. FIN. 101 (Winter 1996); *see also* Prof. John D. Ayer et al., *Out-of-Court Workouts, Prepacks and Pre-arranged Cases: A Primer*, 24 AM. BANKR. INST. J. 16 (Apr. 2005); Ezra G. Levin et al., *The Acquisition of Troubled Companies*, *in* CORPORATE MERGERS AND ACQUISITIONS, at 23, 36 (ALI-ABA Continuing Legal Education No. C115, 1995); Thomas J. Moloney & Shari Siegel, *Legal Issues and Alternatives for Creditors of Troubled Companies*, *in* THE PROBLEMS OF INDENTURE TRUSTEES AND BONDHOLDERS, at 467, 501 (PLI Real Estate L. & Prac. Course Handbook Series No. N4-4591, 1995); A PRACTICAL GUIDE TO OUT-OF-COURT RESTRUCTURINGS AND PREPACKAGED PLANS OF REORGANIZATION § 403[B][2] (Nicholas P. Saggese & Alesia Ranney-Marinelli eds., 2d ed. Supp. 1998).

[26] Trade creditors often receive a full recovery of their claims under a prepackaged plan. This is to assure their good will and cooperation. In addition, it is difficult to solicit the votes of trade creditors outside bankruptcy.

[27] *See* 11 U.S.C. § 363(b)(1) (transactions outside the ordinary course of business require court approval). The "notice and a hearing" requirement also forces the debtor to announce out of the ordinary course business plans publicly before they can be consummated. *See* 11 U.S.C. § 102(1).

[28] Indeed, very few reported decisions involve prepackaged chapter 11 cases.

[29] McConnell et al., *supra* note 26, at 100; *see also* Sandra E. Mayerson, *Current Developments in Prepackaged Bankruptcy Plans, Prepackaged Chapter 11 Plans*, *in* 24TH ANNUAL CURRENT DEVELOPMENTS IN BANKRUPTCY & REORGANIZATION, at 341 (PLI Comm. L. & Prac. Course Handbook Series No. A0-00E6, 2002) ("The advantage most often cited for prepackaged plans is the significant savings in time and expense of this streamlined procedure. This can be somewhat illusory, however, as significant time and expense goes into the planning of a prepackaged chapter 11.").

[30] 241 B.R. 92 (Bankr. D. Del. 1999).

parties to come to an agreement. In addition, if a prepackaged case involves SEC review of plan documents, there can be an extended exchange of SEC comments and revisions, which can cause significant delays.[31]

D. REDUCTION IN EXPENSE

Commentators and practitioners have touted the relative savings in expenses in prepackaged chapter 11 cases.[32] The principal reason given is that a debtor in a freefall chapter 11 is required to pay not only the expenses of its own court-approved professionals, but also the expenses (throughout the length of the case) of the professionals of all statutory committees, which amounts can be significant.[33] Although these commentators note that during the prepetition negotiating period the debtor usually does not have a contractual obligation to pay the expenses of its creditor constituencies,[34] as a practical matter, the debtor usually agrees to pay the expenses of advisors for the holders of its public and private debt.

As discussed below, the organization of a group of creditors to negotiate the terms of the prepackaged plan is essential. Even in the absence of any express contractual obligation, the debtor almost always agrees to pay these expenses as part of the cost of such organization.[35] Empirical studies have indicated that the average prepetition negotiation period is longer than the negotiation period in a freefall chapter 11 case, although the total restructuring time for a prepackaged case is less.[36] In addition, the expense of a registered prepackaged solicitation can add greatly to the overall cost. Nevertheless, researchers have reported that the costs of a prepackaged chapter 11 case, although significant, are generally less than that of a traditional chapter 11 case.[37]

E. REDUCING THE COST OF HOLDOUTS

Almost all debt instruments require the consent of all holders for any significant changes, such as to payment terms or collateral provisions. Obtaining unanimous consent always is difficult, but presents almost insurmountable difficulties in connection with publicly held debt instruments. For the most part, public debt is held anonymously (*i.e.*,

[31] *Id.* at 97 (noting that the SEC reviewed and revised the debtor's plan documents for almost one year before approving such documents).

[32] *See* Bryant B. Edwards & Robert A. Klyman, Comment, *Prepackaged Bankruptcies: Alternative to Traditional Chapter 11*, 6 CHAPTER 11 UPDATE 1, 5 (May 1997); Mayerson, *supra* note 31, at 341.

[33] *See* 11 U.S.C. § 328.

[34] Bank agreements and privately placed debt are exceptions and usually require the debtor to either pay the expenses of the creditor or indemnify the creditor against those expenses.

[35] Often this agreement is undertaken by the debtor with the goal of avoiding payment for the representation of multiple groups.

[36] McConnell et al., *supra* note 26, at 100.

[37] *Id*. at 106.

in "street name"), making it hard to identify the holders. Unless the holders identify themselves, the debtor must use the laborious process of sending notices to registered holders and asking those entities to forward the materials to their respective customers or hiring a service to attempt to identify the holders.[38] A compounding problem is that holders of small amounts of an issue of public debt have little incentive to respond to the debtor's plea for a restructuring.

The result of these problems is that dissenters and nonresponders either must be paid in full in cash or continue to receive their contractual scheduled payments. Therefore, it is typical for a debtor attempting to restructure its publicly held debt out-of-court to condition the restructuring on the consent[39] of holders of at least ninety to ninety-five percent of the outstanding securities. Holders of small amounts of the securities therefore have an incentive to decline the exchange. However, the larger the numbers of these "holdouts," the less likely the success of the restructuring.

Under the Bankruptcy Code, a debtor need only obtain consents representing two-thirds of the amount of the debt voted in the class[40] and a majority of the number of holders in the class that voted.[41] A debtor can combine an exchange offer with a prepackaged plan that would be filed if the requisite nonbankruptcy exchange percentage is not met, thus overcoming some of the natural disincentive to respond to the exchange offer.[42] The theory is that holdouts will believe the securities they receive in an out-of-court restructuring will be worth more than under a chapter 11 plan (due to avoiding the expense and uncertainty of a bankruptcy). They also will realize that the potential use of the prepackaged plan means they have little chance of being paid in full.

[38] It is not unusual for materials to wind their way through several levels before reaching the actual "beneficial holders" of the securities.

[39] The actual form of the consent typically is an "exchange offer" under the federal securities laws under which new securities with different payments terms are offered to be exchanged for the existing securities. *See generally* Securities Act §§ 3(a)(9), 5, 6, 15 U.S.C. §§ 77c(a)(9), 77e, 77f.

[40] Unlike an out-of-court restructuring where the outcome of voting is measured on an individual vote basis, chapter 11 focuses on votes by classes of claims and interests. *See* 11 U.S.C. § 1126. Generally, unsecured claims of equal rank (i.e., not subject to subordination) are classified together for purposes of voting on a plan of reorganization. However, a debtor has flexibility in the designation of classes as long as (i) "dissimilar" claims are not placed in the same class (e.g., secured claims with unsecured claims), and (ii) the chapter 11 plan does not "discriminate unfairly" against dissenting classes. *See id.* §§ 1122, 1129(b).

[41] *See id.* § 1126(c).

[42] Another method to motivate potential holdouts to tender into an exchange offer is to seek consent from all tendering holders to amend the indenture in ways favorable to the debtor (e.g., by softening financial covenants). Such "exit consents" generally are held to be enforceable. *See, e.g.*, Simons v. Cogan, 542 A.2d 785 (Del. Ch. 1987), *aff'd*, 549 A.2d 300 (Del. 1988); Katz v. Oak Indus., 508 A.2d 873 (Del. Ch. 1986).

F. TAX ADVANTAGES

Outside bankruptcy, when a company negotiates a restructuring with its creditors and a portion of its debt is canceled, this cancellation is considered gross income to the debtor. By contrast, the cancellation of debt as part of a chapter 11 plan of reorganization generally is not included in gross income.[43] As a result, a debtor can enjoy more favorable tax treatment by restructuring and canceling debt in the context of a bankruptcy case. Additionally, the tax laws provide more favorable treatment for net operating loss carryforwards after a chapter 11 case than after a non-bankruptcy exchange offer, as long as the majority of the new stockholders are former creditors.[44]

V. COMPETING CONSIDERATIONS

The traditional chapter 11 case can impose a substantial cost on the debtor in terms of a decline in trade credit, employee productivity, and market share. Nonetheless, these ills are likely to befall any distressed borrower when the risk of bankruptcy looms. Because the process of negotiating a prepackaged plan is likely to become public,[45] the debtor most likely will incur these costs whether the case is prepackaged or not. It might even be argued that these costs are less in a traditional chapter 11 case because the earlier commencement of a case creates access to greater liquidity from vendor financing because those parties are assured a priority claim in the case.[46] By contrast, this financing is not available during the out-of-court phase of a prepackaged case, and vendors may become wary and limit the amount of credit extended.

A prepackaged case is not a panacea for all situations of financial distress. This technique is practical only in those situations in which the debtor's financial distress primarily is traceable to burdensome debt levels and the company does not need a comprehensive rehabilitation of its business operations. For example, many of the debtors commencing prepackaged chapter 11 cases in the late 1980s and early 1990s had previously undergone buyouts or similar transactions which had left them substantially overleveraged. In most cases, the entities' underlying business operations were sound. For those companies, a prepackaged restructuring made practical sense because it functioned like a nonbankruptcy securities exchange offer, with such advantages offered by chapter 11 as the ability to bind dissenting minorities and take advantage of favorable

[43] *See* I.R.C. § 108(a)(1)(A).

[44] *See id.* § 382*(l)*(5), (6); *see generally* Timothy R. Pohl et. al., *Out of Court Restructuring and Prepackaged Plans*, *in* DEALING WITH SECURED CLAIMS & STRUCTURED FINANCIAL PRODUCTS IN BANKRUPTCY CASES, at 331 (PLI Comm. L. & Prac. Course Handbook Series No. 3172, 2004).

[45] For example, debtors with registered equity or debt securities have reporting requirements under the federal securities laws. *See* Exchange Act §§ 12, 13, 15 U.S.C. §§ 78l, 78m.

[46] *See* 11 U.S.C. § 503(b) (administrative expenses include the "actual, necessary costs and expenses of preserving the estate"); *id.* § 507(a)(2) (with respect to a business case, administrative expenses are granted first priority, subject only to certain "superpriority" expenses of administration or the expenses in a succeeding chapter 7 case).

tax treatments. Those prepackaged chapter 11 cases left the debtor's business operations essentially unchanged, but deleveraged the company, thereby reducing or eliminating debt service requirements going forward. It is possible that we are about to see a new round of prepackaged plans; however, given the multi-layers of secured debt in today's overleveraged companies, sales of businesses are becoming more common.

There are many reasons other than overleveraging why a debtor will find itself in financial distress. Tools for rehabilitation are available to a prepackaged case debtor *after* the commencement of a chapter 11 case, but their use may result in time-consuming litigation that would prolong the time in chapter 11, and thus, frustrate the principal benefit of a prepackaged case—reduced time under court supervision. As a result, prepackaged plans are not well suited for debtors in a number of situations.

A. NEED FOR THE AUTOMATIC STAY

Out-of-court negotiations often are conducted after the debtor has defaulted on some or all of its outstanding debt. The existence of these defaults gives creditors the ability to exercise their remedial rights. The holder of a public bond, for example, could institute a suit for a missed interest or principal payment.[47] Defaults under one debt instrument often trigger covenant defaults in other instruments, giving the holders of that debt the right to accelerate and exercise remedies. For example, defaults under public debt instruments almost always trigger defaults under bank agreements. Out-of-court restructurings are therefore inherently unstable situations in which one or more creditors may decide, for bargaining leverage or other reasons, to take the dispute to court.[48] The institution of these actions by *unsecured* creditors is not by itself fatal to the out-of-court process, but it does tend to distract management from the negotiations.

Once judgments have been obtained by litigating creditors or if *secured* creditors are exercising remedial rights, the landscape changes dramatically. A creditor that has obtained a judgment has the ability to become secured by "executing" that judgment on assets of the debtor.[49] The only effective way to stop the "race to the courthouse" once it begins is to file a chapter 11 case. The commencement of the case acts as an automatic

[47] Public indentures typically make it difficult for a holder, acting alone, to accelerate the debt. Acceleration usually requires an affirmative instruction to the trustee under the indenture from the holders of twenty-five to fifty percent of the entire issue. However, each holder has the individual right to recover any missed payments. *See* Trust Indenture Act of 1939 § 316(b), 15 U.S.C. § 77ppp(b).

[48] Of course, under these circumstances creditors can commence an involuntary bankruptcy case. *See* 11 U.S.C. § 303. Creditors usually take such action for a number of reasons: they may be dissatisfied with the pace of the negotiations; junior creditors may want to stop the accrual of interest on senior debt, *see id.* § 502(b); and creditors may want to preserve the debtor's right to recover preferential payments to other creditors, *see id.* § 547.

[49] *See, e.g.*, N.Y. C.P.L.R. § 5202(a) (McKinney 1997); CAL. CIV. PROC. § 712.040 (West 1987).

injunction or "stay" of all judicial or nonjudicial actions against the debtor or its property.[50]

B. NEED FOR DEBTOR IN POSSESSION FINANCING

The existence of defaults also has a negative effect on the debtor's ability to continue to finance its operations. Liquidity problems often are compounded by the difficulty in obtaining additional bank borrowings.[51] The solution is to arrange for priority financing in chapter 11. Section 364 of the Bankruptcy Code gives the court the power to authorize postpetition lending on a secured and highest priority basis.[52] Such postpetition financing is well established and is fairly competitive. However, the existence (or imminence) of a chapter 11 case is a prerequisite to this financing.

C. EXECUTORY CONTRACTS AND UNEXPIRED LEASES

If the financial burdens on the debtor relate significantly to the existence of a burdensome contract or lease, the immediate commencement of a chapter 11 case may be the best solution because the Bankruptcy Code allows a debtor, subject to a court's authorization, to reject such an executory contract or unexpired lease or, under certain conditions, to assume and assign (sell) the contract or lease to a third party.[53] The rejection will result in a prepetition unsecured claim against the debtor.[54] The right to reject can apply even to onerous collective bargaining agreements.[55]

D. UNLIQUIDATED OR CONTINGENT CLAIMS

Chapter 11 is a good choice for a debtor with significant unliquidated or contingent claims. The Bankruptcy Code and the Federal Rules of Bankruptcy Procedure provide a number of mechanisms to address the problem of claims which are not immediately ascertainable, but need to be dealt with in order to reorganize successfully. These include the ability to estimate claims,[56] litigate or settle claims,[57] and establish a bar date to sweep in all miscellaneous or unknown claims.[58] Moreover, the channeling

[50] *See* 11 U.S.C. § 362(a).

[51] It is typical for an existing bank agreement (e.g., revolving credit agreement) to condition any further borrowings on no defaults being extant. In addition, banks which are not already lenders will be reluctant to become involved in a financially unstable debtor.

[52] *See* 11 U.S.C. § 364(c). Under certain circumstances, loans under § 364 may be secured by liens that are senior to the liens of existing secured creditors. *Id.* § 364(d).

[53] *See* 11 U.S.C. § 365(a)–(c).

[54] *See id.* §§ 365(g), 502(g).

[55] *See id.* § 1113.

[56] *See* 11 U.S.C. § 502(c).

[57] *See* FED. R. BANKR. P. 3007, 9019.

[58] *See* FED. R. BANKR. P. 3001–3006.

injunction under § 524(g) of the Bankruptcy Code provides additional advantages to resolving such claims. The mechanisms outside chapter 11 used to address these issues, such as class action suits, are not focused on the rehabilitation process. In addition, it is difficult to formulate a procedure outside chapter 11 to seek approval of a reorganization plan from the holders of such unliquidated or contingent claims.[59] Thus, debtors in this situation may be better off pursuing a traditional chapter 11 case.

Notwithstanding these very significant obstacles, a number of recent cases involving mass torts have attempted to take advantage of the bankruptcy channeling injunction in prepackaged chapter 11 cases.[60] The use of prepackaged chapter 11 cases in this context, however, has been criticized by both courts and commentators alike.[61]

E. NEED TO SOLICIT GENERAL UNSECURED CREDITORS

The prepetition solicitation of votes on a chapter 11 plan requires compliance with "applicable nonbankruptcy laws" concerning the adequacy of disclosure.[62] The federal securities laws, rules, and regulations govern and provide significant guidance when the proposed restructuring involves the issuance of securities to the holders of the debtor's existing securities or exchange of new securities for the debtor's existing securities. Those rules were not intended to cover the solicitation of general unsecured creditors of a company and it is uncertain how they would apply.[63] Therefore, if the success of a

[59] For example, the Federal Rules of Bankruptcy Procedure provide that the prepetition acceptance or rejection of a plan may not be counted unless the plan was transmitted to all similarly situated creditors. FED. R. BANKR. P. 3018. In a toxic tort situation, the debtor probably will not know the identities of all potential plaintiffs. Once the case is commenced, however, procedures can be established for the notification of potential claimants and the requirement for filing proofs of claim.

[60] The first prepackaged mass tort asbestos bankruptcy was filed by Fuller-Austin Insulation Company on September 4, 1998. *In re* Fuller-Austin Insulation Co., No. 98-2038 (JJF) (Bankr. D. Del. Sept. 4, 1998). *In re* Fuller-Austin was followed by, among others, *In re* Shook & Fletch Insulation Co., No. 02-02771-BGC-11 (Bankr. N.D. Ala. April 8, 2002), *In re* J.T. Thorpe Co., No. 02-41487-H5-11 (Bankr. S.D. Tex. Oct. 1, 2002), and *In re* Combustion Eng'g, Inc., No. 03-10495 (Bankr. D. Del. Feb. 17, 2003).

[61] *See In re* Combustion Eng'g, Inc., 391 F.3d 190, 235-38 (3d Cir. 2004) (vacating and remanding for further consideration the district court's decision to confirm a prepackaged asbestos-related plan that extended the channeling injunction to nondebtor affiliates where the requirements of § 524(g) of the Bankruptcy Code were not satisfied); *In re* ACandS, Inc., 311 B.R. 36 (Bankr. D. Del. 2004) (denying confirmation of a prepackaged asbestos chapter 11 plan); *see also* Kenneth Pasquale, *Combustion Engineering: Setting Limits on Pre-Packaged Asbestos Bankruptcies*, 24 AM. BANKR. INST. J. 36 (2005); Mark D. Plevin et al., *Pre-Packaged Asbestos Bankruptcies: A Flawed Solution*, 44 S. TEX. L. REV. 883, 907 (2003) (criticizing prepackaged asbestos bankruptcies as "pervert[ing] and distort[ing] the purposes of Section 524(g) of the Bankruptcy Code").

[62] *See* 11 U.S.C. § 1126(b).

[63] For example, section 3(a)(9) of the Securities Act provides an exemption from registration for certain types of exchanges of securities. However, this exemption would not be applicable to the solicitation of trade creditors because these entities do not hold "securities." *See infra* note 93 (definition of "security" under Securities Act).

restructuring depends on the modification of the claims of creditors that do not hold "securities," the commencement of a traditional chapter 11 case is more appropriate.[64]

F. Problems with Equity Holders

The term "prepackaged" chapter 11 case almost always refers to a situation in which the votes of *creditors* have been obtained before the commencement of the chapter 11. Little focus is given to shareholders or equity holders. In fact, there is almost a practical presumption that a debtor needing to restructure its financial obligations is insolvent. Therefore, in most prepackaged chapter 11 cases shareholders receive no property under the proposed plan. If the equity of the debtor is privately held, such treatment is rarely problematic because the shareholders are usually parties to the negotiations.[65] However, this is not the case for public companies. If the question of solvency is close enough, public shareholders that were not part of the prepetition negotiations may dispute valuation.

For example, in *In re Zenith Electronics Corp.*,[66] the statutory committee of equity securityholders and numerous shareholders disputed the valuation undertaken by the debtor's investment banker and objected to confirmation of the debtor's plan of reorganization. Although the court ultimately upheld the debtor's valuation, confirmation of the plan was delayed for approximately one month.[67]

Furthermore, in *In re THCR/LP Corp.*,[68] an equity securityholders' committee was appointed over the objections of the debtors and the ad hoc committees of noteholders. The debtors and certain parties in interest had spent almost a year negotiating the terms of a comprehensive restructuring; however, the equity securityholders, with the exception of one major shareholder, alleged that they were the only constituency that lacked a sufficient opportunity to participate in the prepetition negotiations. By its appointment, the equity committee effectively forced a renegotiation of the terms of the debtors' plan of reorganization and demonstrated that the shareholders were entitled to a significantly higher distribution (approximately $30 million more) than the debtors' plan initially contemplated. Thereafter, settlement negotiations with the debtors, the equity committee, and other parties in interest resulted in the confirmation of a plan of reorganization.

[64] *But see* discussion below of partially prepackaged cases.

[65] As a practical matter, privately owned companies are not likely to engage in restructuring negotiations without the tacit, if not active, consent of the owners of the business.

[66] 241 B.R. 92, 103-05 (Bankr. D. Del. 1999).

[67] *Id.*

[68] No. 04-46898 (D.N.J. 2004).

G. Need to Reorganize a Complex Structure of Operating Companies

It is much easier to structure a prepackaged plan for a holding company than a series of operating companies because bankruptcy case administration and reporting requirements multiply for the latter. Furthermore, the fewer trade creditors that a debtor has (as compared to more sophisticated financial creditors), the easier it might be to persuade them not to take precipitous action during the pre-filing period when the prepackaged case is being negotiated.

VI. PREPACKAGING OPTIONS

With time and experience, variations have emerged along a spectrum based on how "complete" or how "consensual" the negotiation process stands on the commencement date. Currently there are a number of prepackaging options, offering the debtor a range of benefits once the actual case is commenced.

A. Dual-Track Cases—Fully Prepackaged

"Dual-track" fully prepackaged chapter 11 cases are ones involving a debtor with public securities. The debtor negotiates and solicits acceptances to both a securities exchange offer and a chapter 11 plan prior to the commencement of a case. The securities exchange offer provides that it will become effective if a set minimum percentage of holders vote to accept it. Generally, this minimum percentage is ninety to ninety-five percent of the holders. If that percentage is not reached, acceptances of the exchange are treated as acceptances of a chapter 11 plan of reorganization which has a lower approval threshold.[69] This dual approach can act as an incentive to potential holdouts to tender their securities in the exchange.

The advantage of the dual-track approach is that a restructuring may be accomplished without the need to resort to an actual chapter 11 case, while providing the security of an immediate fallback mechanism. Customers and suppliers may consider this route of less concern. If the exchange offer does not reach acceptable levels, no additional time need be spent on a chapter 11 solicitation (assuming the chapter 11 voting requirements have been met). Many of the earliest modern-day prepackaged chapter 11 cases were structured as dual-track cases.

With a dual-track case, a debtor can attempt to restructure its indebtedness without resorting to chapter 11. Although a dual-track case may be time-consuming as to negotiation, solicitation, and preparation, if a debtor is successful, the cost and delay of chapter 11 can be avoided. If, however, the offer is not accepted by ninety to ninety-five

[69] Technically, rather than simply relying on the tender of securities into the exchange offer as the "vote" in favor of the chapter 11 plan, a debtor using this dual-track method should distribute, with the exchange offer materials, ballots meeting the requirements of the official form. *See* Fed. R. Bankr. P. 3018(c). However, providing separate ballots raises the possibility that some holders will tender into the proposed exchange offer, but fail to return completed ballots.

percent of the holders but the requisite majorities for confirmation of a chapter 11 plan are met, the debtor can commence a chapter 11 case promptly to bind all the holders without the need to buy out dissenters.[70]

B. SINGLE-TRACK CASES—FULLY PREPACKAGED

A "single track" fully prepackaged chapter 11 case is one in which the debtor negotiates and proposes a reorganization plan and solicits acceptances of the plan with the intent to commence a chapter 11 case upon completion of a successful solicitation. Compared to the dual-track variation, this is a simpler process in terms of disclosure and avoids the potential confusion among creditors about tendering their securities and a separate chapter 11 plan ballot. The principal disadvantage is that the commencement of such a solicitation is a tacit admission by the debtor that chapter 11 is inevitable, even if sufficient votes for this particular plan are not received. Single-track prepackaged chapter 11 cases are most frequently used when the creditor body is comprised of manageable numbers of institutional players, allowing negotiations to be conducted directly.

In re Choice Communications Inc.[71] is a recent example of a successful fully prepackaged chapter 11 case. Through distribution of a disclosure statement to those creditors entitled to vote on their joint plan of reorganization, the debtors solicited votes to accept or reject the plan prior to filing for chapter 11 protection. The plan, which was the result of several months of negotiations between the debtors and the holders of senior debt and subordinated notes claims, was overwhelmingly accepted by the creditors entitled to vote on the plan, with affirmative votes of 100%. Thereafter, the debtors commenced their cases under chapter 11 and successfully emerged in forty-four days.

C. PARTIALLY PREPACKAGED CASES

Under certain circumstances, it may be advantageous to solicit votes of certain creditors prior to the commencement of the chapter 11 case, while soliciting the remainder under the aegis of the bankruptcy court. For example, a company which needs to restructure general unsecured debt may improve the chances of receiving the requisite acceptances from that group if it already has received approvals from the holders of its private and public debt. The split solicitation is also used to avoid the expensive and

[70] For example, the exchange offer in the restructuring of the public debt of the Brock Hotel Corporation (the largest Hilton hotel franchisee at the time) was successful. In comparison, Pioneer Finance Corporation did not meet the required percentages in its exchange offer and commenced a chapter 11 case. *See In re* Pioneer Fin. Corp., No. BK-S-99-11404 LBR (Bankr. D. Nev. 1999); *see also* Insight Health Svcs. Holdings Corp., No. 07-10700 (Bankr. D. Del. 2007) (commencing prepackaged chapter 11 case where the plan proponent did not meet the condition precedent that 97% of note holders tender their notes by the expiration of the prepetition exchange offer).

[71] No. 04-16433 (RDD) (Bankr. S.D.N.Y. 2004).

time-consuming registration process under the securities laws and to take advantage of the solicitation safe harbor provided by § 1125(e) of the Bankruptcy Code.

An example of a partially prepackaged case is *In re Sunshine Precious Metals, Inc.*[72] There, the debtor solicited votes on a chapter 11 plan by all bondholders other than those residing in the state of California. It avoided solicitation of California residents because a California securities law required certain approvals by state regulators. Instead, the debtor chose to solicit acceptances from California residents after it had commenced its chapter 11 case. A creditors' committee appointed in the case argued that the debtor could not bifurcate the solicitation in this manner. The court overruled the committee and found that the provisions of § 1126, which govern both prepetition and postpetition solicitations, "do not specifically prohibit such procedure and the statute language would indicate no prohibition of combining prefiling and postfiling solicitation."[73]

D. Pre-Arranged or Prenegotiated Cases

The complications of prepetition solicitation can be avoided altogether, while retaining most of the advantages of a prepackaged chapter 11 case. A "pre-arranged" or "prenegotiated" case is one in which all the negotiations take place prior to the commencement of the case. The debtor then files its plan of reorganization and disclosure statement at the time it commences its chapter 11 case. On the commencement date, the debtor requests the court to schedule a hearing to approve its proposed disclosure statement.[74] Solicitation of votes occurs after the court approves the disclosure statement. The additional time in bankruptcy for a successful prenegotiated case can be as little as sixty to ninety days (i.e., the time necessary for a hearing on the disclosure statement and solicitation of acceptances and rejections).[75]

The principal disadvantage of the prenegotiated variation is that the debtor commences its chapter 11 case with no assurance that the plan it files will be accepted. In contrast, in a single-track prepackaged case, the debtor already has received the necessary acceptances for confirmation of its plan. Although confirmation of that plan is not

[72] 142 B.R. 918 (Bankr. D. Idaho 1992).

[73] *Id.* at 920.

[74] An example of a prenegotiated chapter 11 case is *In re* Syratech Corp., No. 05-11062 (RS) (Bankr. D. Mass. 2005), which was filed on February 16, 2005 and confirmed on May 12, 2005. Prior to filing, the debtors negotiated the terms of the plan with an unofficial committee of senior noteholders to reach a consensual restructuring of the debtors' indebtedness.

[75] Fed. R. Bankr. P. 2002 requires twenty-five days' notice of the deadline for filing objections to a disclosure statement and of the hearing to consider approval of a disclosure statement. The extent of the solicitation period varies depending on the number of holders of claims and interests and whether these claims are based on public securities. A thirty-day voting period is usually sufficient and shorter periods have been used.

guaranteed, careful planning and adherence to the requisite legal standards[76] should reduce risks to a minimum.

E. LOCKUPS

One method to reduce the risks of a prenegotiated plan is to attempt to bind key creditors to vote for the plan they negotiated with the debtor prior to the commencement of the case. These arrangements generally are referred to as "lockup agreements" or "lockups" and can be controversial. On the one hand, lockup agreements can be considered an end-run around the Bankruptcy Code's disclosure and solicitation requirements. They are the result of the solicitation of some creditors prior to the commencement of the case without using the required forms or a court-approved disclosure statement.[77] On the other hand, if chapter 11 is not the only restructuring option available, it would be grossly unfair for creditors involved in the negotiations to withdraw their support after the commencement of the case.

One of the few reported cases on the validity of a lockup agreement was in the context of the settlement of a disputed claim during the pendency of a chapter 11 case. In *Transworld Airlines, Inc. v. Texaco Inc. (In re Texaco Inc.)*,[78] Texaco executed an agreement as part of the settlement of a $12,000,000,000 claim filed by Pennzoil. In that agreement, Pennzoil and Texaco agreed to "take all necessary actions to achieve confirmation" of the plan proposed by Texaco.[79] The two parties also agreed not to support any modification of the plan without the consent of the other, and agreed not to "vote for, consent to, support or participate in the formulation of" any other plan.[80] Carl Icahn sought to propose a competing plan and requested a declaratory judgment from the bankruptcy court that the lockup agreement was void and unenforceable because it violated the Bankruptcy Code's provisions regarding vote solicitation. The court denied Icahn's motion, and found that there was no improper solicitation because Pennzoil only agreed not to vote for a competing plan. Neither was the agreement a vote against a competing plan because none had been filed. The court concluded that the agreement was proper because it represented negotiations concerning a plan.

Mr. Icahn also challenged the lockup agreements in the prearranged bankruptcy case of *E-II Holdings Inc.*[81] Unlike in *Texaco*, the debtor in *E-II* was not a party to the

[76] A prepackaged chapter 11 plan must meet the same standards as any other chapter 11 plan. In general, this means that the plan must comply with the provisions of §§ 1123 and 1129 of the Bankruptcy Code.

[77] Postpetition solicitation can take place only with an approved disclosure statement. *See* 11 U.S.C. § 1125(b). In addition, prepetition solicitation is effective only if a disclosure statement is transmitted to all similarly situated creditors. FED. R. BANKR. P. 3018(b).

[78] 81 B.R. 813 (Bankr. S.D.N.Y. 1988).

[79] *Id.* at 814–15.

[80] *Id.*

[81] *In re* E-II Holdings Inc., No. 92-B-43614 (CB) (Bankr. S.D.N.Y. June 25, 1992).

lockup arrangement. In that case, large portions of the publicly held debt had changed hands during the prepetition negotiating process, causing changes in the overall agreement. These changes significantly delayed the filing of the case. The creditors involved at that time determined among themselves that it was in their interests to obtain commitments to support the current proposal. Because the debtor was not a party to the lockup, an argument based on improper solicitation was not available.[82] Mr. Icahn argued that the creditors that had negotiated the prearranged plan breached their "fiduciary duties" to other creditors by entering into the lockup agreements. Ultimately, a court-appointed examiner exonerated the actions of the creditors.

In *In re Kellogg Square Partnership*,[83] another lockup agreement was challenged. The court found that the agreement did not violate the solicitation and voting rules because the creditor merely pledged to use "best efforts" on behalf of plan confirmation; the agreement contained no language by which the creditor affirmatively "supported" the plan.

Although not binding precedent, the U.S. Bankruptcy Court for the District of Delaware issued bench rulings in two cases that provide a "bright-line" rule for the use of lockup agreements in connection with prenegotiated plans. In *In re Stations Holding Co.*,[84] the court held that lockup agreements executed several months after the petition was filed were unenforceable because such agreements amounted to a postpetition solicitation of votes prior to court approval of the disclosure statement in violated of § 1125(b) of the Bankruptcy Code. The court in *Stations Holding* designated the votes of the parties who executed the lockup agreements postpetition, as cast in bad faith, and disallowed their votes.

In another case, *In re NII Holdings Inc.*,[85] the court provided further guidance with respect to the enforceability of lockup agreements. In *NII Holdings*, although the court held that certain lockup agreements executed days after the commencement of the debtor's chapter 11 case violated § 1125(b) of the Bankruptcy Code, the court upheld the enforceability of identical lockup agreements fully executed prior to the commencement of the bankruptcy case. The *NII Holdings* court held that it did not have jurisdiction over such prepetition lockup agreements because the debtors were not attempting to use the prepetition lockup agreements as votes in favor of the debtor's plan. Instead, the creditors executing the lockup agreements prepetition cast their votes in favor of the plan after the bankruptcy court approved the written disclosure plan in compliance with

[82] In *E-II Holdings*, major portions of the public debt had changed hands.

[83] 160 B.R. 336 (Bankr. D. Minn. 1993).

[84] No. 02-10882 (MFW) (Bankr. D. Del. Sept. 30, 2002), *discussed in* Daniel J. DeFranceschi, *Delaware Bankruptcy Court Announces Bright Line Rule for Use of Lock-Up Agreements in Chapter 11 Cases*, 22 AM. BANKR. INST. J. 16 (Feb. 2003) and Don S. DeAmicis, *Bondholder Workouts In and Out of Bankruptcy*, 12 J. BANKR. L. & PRAC. 37, 46-47 (2003).

[85] No. 02-11505 (MFW) (Bankr. D. Del. Oct. 25, 2002).

section 1125(b). Accordingly, a debtor intending to file a prenegotiated plan must ensure that all lockup agreements are fully executed prior to filing its bankruptcy case in order for the votes of creditors executing such agreements to be counted.

Sometimes litigation or controversy arises during a prepackaged chapter 11 case that significantly delays the restructuring. In those situations it is often important that creditors supporting the proposed plan are members of the statutory creditors committee, if one is appointed. The creditors' committee, as one of the "official" voices in the chapter 11 case, often has an important role in shaping the course of the case. It can be very painful to the restructuring process if only creditors opposing confirmation dominate the creditors' committee.[86] However, in the District of Delaware the execution of a lockup agreement prior to the commencement of a chapter 11 case will disqualify that creditor from serving on the creditors' committee.[87] The rationale is that members of the creditors' committee are fiduciaries whose actions must be unfettered in representing all unsecured creditors. In the Southern District of New York, the United States Trustee has not considered the execution of lockup agreements as necessarily fatal to membership on the creditors' committee. However, the lockup agreements must explicitly provide that if the creditor is appointed to the committee, the exercise of its fiduciary obligations shall not be a violation of the other provisions of the lockup.

VII. TECHNIQUES FOR A SUCCESSFUL PREPACKAGED CASE

In a traditional chapter 11 case, the bankruptcy court is available to make binding determinations about the extent of disclosure, solicitation procedures, classification of claims and interests, and other key matters. In contrast, in a prepackaged case, the court rules on these issues only after the solicitation has occurred and the case has been commenced. The potential consequences of making an error in any of these matters include resoliciting votes during the case, reformulating the plan, and potentially transforming the case into a freefall chapter 11 and all the uncertainties that are inherent in the traditional chapter 11 process.[88] To avoid these pitfalls, a debtor contemplating a prepackaged case should avoid unusual plan formulations and conservatively apply the disclosure and solicitation requirements.

[86] *See* 11 U.S.C. § 328 (providing for payment by the debtor of the reasonable compensation and expenses of the professionals employed by the creditors' committee).

[87] *NII Holdings*, No. 02-11505 (MFW) (upholding the United States Trustee's decision to refuse the appointment to any statutory committee of bondholders that had signed a lockup agreement).

[88] A prepackaged chapter 11 case usually is based on a consensual understanding between the debtor and representatives of major creditor groups. However, there is no guaranty against the appearance of dissidents. For example, in *In re* Southland Corp., 124 B.R. 211 (Bankr. N.D. Tex. 1991), a minority group of bondholders that had been outvoted during the prepetition voting successfully challenged the debtor's solicitation procedures. Furthermore, in *In re* Zenith Elecs. Corp., 241 B.R. 92 (Bankr. D. Del 1999), the official committee of equity holders and a number of shareholders objected, although unsuccessfully, to the adequacy of the debtor's disclosure statement and confirmation of the plan.

A. PREPETITION DISCLOSURE—SUBSTANTIVE REQUIREMENTS

The Bankruptcy Code provides that plan acceptances obtained prior to the filing of the bankruptcy petition are valid and binding if:

(1) the solicitation of such acceptance or rejection was in compliance with *any applicable nonbankruptcy law, rule, or regulation governing the adequacy of disclosure* in connection with such solicitation, or

(2) *if there is not any such law, rule, or regulation,* such acceptance or rejection was solicited after disclosure to such holder of adequate information, as defined in section 1125(a) of this title.[89]

There is no nonbankruptcy law that expressly applies to chapter 11 plans of reorganization. However, the antifraud provisions of the securities laws would apply to a plan that proposes the exchange or issuance of "securities."[90] Insofar as the issuance of securities (as well as other property) is common under a chapter 11 plan, the prudent course is to satisfy both the Bankruptcy Code and securities laws disclosure standards.

B. ANTIFRAUD PROVISIONS OF THE SECURITIES LAWS

The federal securities laws impose civil liability for failure to make proper disclosure in a prospectus or other filing. Under the Securities Act, liability arises for any prospectus or oral communication "which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading."[91] Similarly, the Exchange Act imposes liability for any statement in a document filed with the SEC which "was at the time and in the light of the circumstances under which it was made false or

[89] 11 U.S.C. § 1126(b) (emphasis added).

[90] Under the Securities Act, "security" is defined as:

> any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

§ 2(a)(1), 15 U.S.C. § 77b(a)(1).

[91] *See id.* § 12(a)(2), 15 U.S.C. § 77l(a)(2).

misleading with respect to any material fact."[92] In short, the federal securities law requirements focus on the absolute truth of disclosure.

C. "ADEQUATE INFORMATION" UNDER THE BANKRUPTCY CODE

In contrast to the securities laws, the Bankruptcy Code provides a result-oriented disclosure standard, requiring only that "adequate information" be provided to those voting on a plan;[93] no reference is made to truthfulness per se.[94] The standard is intended to be applied flexibly, tailored to the circumstances of particular cases, based on the availability of information and the relative sophistication of the parties.[95]

Courts have interpreted the adequate-information standard to require information that might not normally be encountered in filings under the federal securities laws. For example, the following items usually are contained in a disclosure statement, not all of which might be found in a registration statement: a summary of the proposed plan of reorganization, a description of all asset values and the basis on which the values were determined, a description of the claims against the debtor's estate, a liquidation analysis, an estimate of all administrative expenses of the chapter 11 case, projections of the future operations of the reorganized debtor, a description and estimate of success of possible litigation on behalf of the estate, and a list of the parties that served on the negotiating committees in preparing the plan. Courts have enumerated many other items that may be required given the circumstances of the case.[96]

[92] *See id.* § 18(a), 15 U.S.C. § 78r(a).

[93] *See* 11 U.S.C. § 1125(b).

[94] *See* 11 U.S.C. § 1125(a) (emphasis added) (requiring such information as would enable a "hypothetical investor of the relevant class to make an informed judgment about the plan"). The issue of truthfulness is subsumed in the larger question of adequacy; if material false statements or omissions are shown to exist, a court can refuse to approve a disclosure statement as inadequate.

[95] *See id.*; H.R. REP. NO. 95-595, at 226–27 (1977). In accordance with this flexible standard, under the 2005 Amendments, § 1125(a)(1) of the Bankruptcy Code was amended to provide that in determining whether a disclosure statement provides adequate information, the court must consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information.

[96] Additional requirements courts have developed include: the circumstances that gave rise to the filing of the bankruptcy petition; the sources of the information provided in the disclosure statement; a disclaimer that no statements concerning the debtor are authorized other than those set forth in the disclosure statement; the condition and performance of the debtor while in chapter 11; the accounting and valuation method used to produce the financial information; information regarding the future management of the debtor, including compensation to be paid to insiders, directors and officers; an assessment of the collectibility of accounts receivable; any financial statements, valuations, or pro forma projections relevant to determinations of whether to accept or reject the plan; a discussion of the risks taken by the creditors and interest holders; the estimated amounts to be recovered in connection with avoidable transfers; the tax consequences of the plan; and the debtor's relationships with its affiliates. *See In re* Ferretti, 128 B.R. 16, 18–19 (Bankr. D.N.H. 1991); *In re* Scioto Valley Mortgage Co., 88 B.R. 168, 170–71 (Bankr. S.D. Ohio 1988).

D. THE SAFE HARBOR

Section 1125(e) of the Bankruptcy Code creates a "safe harbor" from liability under state and federal securities laws for good faith solicitations of votes on a chapter 11 plan. It is not clear, however, whether the safe harbor applies to prepetition solicitations of votes on prepackaged chapter 11 plans.[97] The heading of § 1125 of the Bankruptcy Code is styled "*Post*petition disclosure and solicitation," although section headings are neither conclusive nor binding. Yet the plain language of § 1125(e) of the Bankruptcy Code exempts from liability all solicitation undertaken in good faith and "in compliance with the applicable provisions of this title." Thus, it can be argued that if a prepackaged plan complies with the requirements of § 1126(b) of the Bankruptcy Code governing prepetition disclosure, liability will not arise.

E. THE REQUIREMENT OF GOOD FAITH

The Bankruptcy Code provides that votes may be disregarded if they are "not solicited or procured in good faith or in accordance with the provisions of this title."[98] Although the Bankruptcy Code does not contain any further reference to "good faith" solicitations, case law in the context of a traditional chapter 11 case provides some guidance. For example, in *In re Allegheny International*, *Inc.*,[99] a third party that was interested in obtaining control over the debtor purchased sufficient claims in two key classes to block acceptance of the debtor's chapter 11 plan. The court found that the purchase of claims for the purpose of blocking acceptance is not tantamount to "bad

[97] *Compare* Richard M. Cieri et al., *Safe Harbor in Uncharted Waters—The Securities Law Exemptions Under Section 1125(e) of the Bankruptcy Code*, 51 BUS. LAW. 379 (1996) (§ 1125(e) exemption should be available for solicitations connected with prepackaged plans of reorganization), *and* Stephen H. Case & Mitchell A. Harwood, *Current Issues in Prepackaged Chapter 11 Plans of Reorganization and Using the Federated Declaratory Judgment Act for Instant Reorganizations*, 191 ANN. SURV. AM. L. 75 (1992) (§ 1125(e) should apply to prepackaged plans of reorganization), *with* Steven F. Gross & George E.B. Maguire, *Prepackaged Chapter 11 Plans*, *in* CHAPTER 11 BUSINESS REORGANIZATIONS 1994, at 475 (PLI Comm. L. & Prac. Course Handbook Series No. A4-4444, 1994) (stating that prepetition solicitation is subject to the securities laws), *and* Stephen E. Sherman, *Overview of Bankruptcy From the Indenture Trustee's Perspective*, *in* THE PROBLEMS OF INDENTURE TRUSTEES AND BONDHOLDERS 1994: DEFAULTED BONDS, HIGH YIELD ISSUES AND BANKRUPTCY, at 367 (PLI Comm. L. & Prac. Course Handbook Series No. N4-4582, 1994) ("Pre-filing solicitation will almost always require SEC review of the proxy materials while post-filing requires only approval of the bankruptcy court under section 1125"), *and* Karen E. Wagner, *Representing a Business Debtor*, *in* UNDERSTANDING BUSINESS BANKRUPTCY 1992: HOW TO HANDLE EVERYDAY PROBLEMS—A SATELLITE PROGRAM, at 51 (PLI Commercial Law and Practice Course Handbook Series No. A4-4393, 1992) ("If acceptance of the plan is pre-solicited, compliance with securities laws may be required."), *and* Leonard M. Rosen & Susan M. Treyz, *Plan Acceptance and Disclosure Statement; SEC Interplay; Plan Confirmation: Developments During 1991*, *in* CURRENT DEVELOPMENTS IN BANKRUPTCY AND REORGANIZATION 1992, at 903 (PLI Commercial Law and Practice Course Handbook Series No. A4-4377, 1992) (stating public companies must comply with the Exchange Act and the rules and regulations promulgated by the SEC).

[98] 11 U.S.C. § 1126(e).

[99] 118 B.R. 282 (Bankr. W.D. Pa. 1990).

faith," as long as the purchaser is acting in its own economic interest. However, the court found that the purchaser in this case had the ulterior and undisclosed motive of obtaining control over the debtor through the plan process. The court found that this motivation was sufficient to determine that the votes of that creditor should be disregarded.[100]

In another traditional chapter 11, *Figter Ltd. v. Teachers Insurance & Annuity Ass'n of America (In re Figter Ltd.)*,[101] the United States Court of Appeals for the Ninth Circuit provided some additional gloss on the good-faith requirement. In *Figter*, a secured creditor purchased unsecured claims against a debtor for the purpose of defeating confirmation of the debtor's plan. The debtor sought to have those votes not counted as cast in bad faith under § 1126(e) of the Bankruptcy Code. However, the court found that § 1126(e) was intended to apply only to creditors "whose selfish purpose was to obstruct a fair and reasonable reorganization in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupt assets."[102] The court found that the mere purchase of claims to block confirmation of a plan is not per se bad faith. Rather, the particular facts must show pure malice, blackmail, the intent to destroy a competitor's business, or some similar ulterior motive. In *Figter*, the court found that the facts of that case showed no bad faith.

Although most of the cases interpreting § 1126(e) of the Bankruptcy Code have centered on plan rejections, there is case law indicating that acceptances also must be made in good faith. For example, acceptances have been disallowed when it appeared that votes were "bought" by the debtor's parent.[103]

VIII. PREPETITION SOLICITATION— PROCEDURAL REQUIREMENTS

A. WHO MAY VOTE?

Federal Rule of Bankruptcy Procedure 3018(b) requires that securities be voted by "the holder of record of the security."[104] Bankruptcy courts have required that plan proponents solicit beneficial owners of securities, not just the holders whose names were registered either on the books and records of the company or the registry maintained by the trustees for the indentures under which the securities were issued.[105]

[100] *Id.* at 289–90.

[101] 118 F.3d 635 (9th Cir.), *cert. denied*, 522 U.S. 996 (1997).

[102] *Id.* at 638 (quoting Young v. Higbee Co., 324 U.S. 204, 210–11 (1945)).

[103] *See, e.g.*, *In re* Featherworks Corp., 25 B.R. 634 (Bankr. E.D.N.Y. 1982) (postpetition solicitation and voting), *aff'd*, 36 B.R. 460 (E.D.N.Y. 1984).

[104] FED. R. BANKR. P. 3018(b).

[105] *See In re* Southland Corp., 124 B.R. 211 (Bankr. N.D. Tex. 1991) (ordering a resolicitation of the vote to reach beneficial holders); *see also In re* Pioneer Finance Corp., 246 B.R. 626 (Bankr. D. Nev. 2000) (denying confirmation of the debtors plan where the debtor solicited votes prepetition from only the registered bondholders and holding that substantially all creditors that were affected by the plan—

Requiring the vote of beneficial owners makes the prepackaged solicitation process for publicly held debt more difficult. Prior to the bankruptcy filing, proponents of a plan may have difficulty identifying beneficial holders. Generally, the record holders of the debtor's securities consist of nominees, such as the Depository Trust Company, [106] which hold title to allow beneficial interests to trade freely. The Depository Trust Company maintains records showing the holdings (and trades) of its member institutions. Those members consist of brokers, investment advisors, and other financial institutions, each of which may be holding for the benefit of other unidentified customers. These ultimate beneficial holders may or may not have consented to the disclosure of their names and holdings.[107] In practice, the votes of beneficial owners have been obtained through the voluntary cooperation of record holders in passing along solicitation materials to their customers although firms exist today that assemble lists of ultimate beneficial holders that do not object to the disclosure of such information.[108]

B. HOW ARE VOTES TO BE COUNTED?— THE "NUMEROSITY" REQUIREMENT

As discussed above, the acceptance of a plan by a class of claims requires a dual affirmative vote—two-thirds of the amount of the claims voting *and* a majority of the holders of such claims. The second prerequisite, often referred to as the "numerosity" requirement, does not exist outside chapter 11. No foolproof mechanism has been developed to count the number of holders voting when securities are held in street name.

In chapter 11, the plan proponent can ask the court to direct the brokerage houses and banks to disclose the identities of their clients. To address this issue in the prepetition context, the industry-wide standard is for a plan proponent in a prepackaged chapter 11 case to require two levels of ballots—so-called "master" ballots and "baby" ballots.[109] The depository entities authorize the distribution of solicitation materials directly to their clients by executing an omnibus proxy. Both sets of ballots are then distributed to the brokerage houses and banks identified by those depositories. The brokerage houses and banks retain the master ballot and distribute the baby ballot and the disclosure statement to their customers. Banks typically execute the blank baby ballots before distribution and

specifically the beneficial holders—did not receive adequate notice); FED. R. BANKR. P. 3017(e) (requiring the transmission of the disclosure statement to beneficial holders).

[106] The name used by The Depository Trust Company for securities is "Cede & Co."

[107] Pursuant to rules promulgated under the Exchange Act, issuers of securities may obtain the identities and addresses of the customers of brokerage houses and banks who have not "objected" to the release of this information. *See* 17 C.F.R. §§ 240.14b-1(b)(3)(i), 240.14b-2(b)(4)(ii) (2005). The customers who object to this disclosure are referred to as "OBOs" ("objecting beneficial owners"), and those who do not object as "NOBOs" ("nonobjecting beneficial owners").

[108] Once a chapter 11 case has been commenced, the debtor may ask the court to direct the record holders to disclose the names of their customers. This disclosure can be accomplished in a manner that will minimize the risk that the names of the beneficial holders will become publicly known.

[109] *See* JPS Textile Group, No. 91 B 10546 (JAG) (S.D.N.Y. Mar. 21, 1991) (order approving disclosure statement and solicitation procedures).

instruct their customers to return them directly to the plan proponent. Brokerage houses collect the ballots from their customers and record the votes on the master ballots. The master ballots are then submitted to the plan proponent.

To address the numerosity issue, the ballots collect two kinds of information. First, the baby ballots require the beneficial holder to certify whether it holds securities in the same class with a different broker. This information assures that the vote of that beneficial holder is not counted more than once. Second, the amount and identifying account number (but not the identity) from the baby ballots are transcribed by the brokerage houses to the master ballots. This information allows the plan proponent to tally the number of holders voting as well as the number of acceptances and rejections.

It is important to note that this procedure works in theory, but has not been challenged. Its principal disadvantage is that the plan proponent relies on the certifications in the baby ballots and the master ballots without independent verification. If a party challenges the solicitation and takes discovery of the brokerage houses, banks, and their respective customers, the plan proponent may find out for the first time that solicitation problems exist. However, it will also be difficult for a dissident to determine whether there were any improprieties in the solicitation process. It seems unlikely that a court would allow unlimited discovery to a plan dissident to conduct a fishing expedition in the hopes of discovering an anomaly in the voting process.[110] Therefore, a plan proponent increases its chances of surviving scrutiny of the voting process by conducting the solicitation carefully and retaining a reputable third party to tabulate the votes.[111]

C. How Long Must the Solicitation Period Be Open?

Votes on a prepackaged plan will not be counted if "an unreasonably short time was prescribed . . . to accept or reject the plan."[112] Unfortunately, neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure provides further guidance on establishing the appropriate voting period. Nonbankruptcy law is helpful on this subject, but not necessarily determinative. For example, the rules under the securities laws prescribe that tender offers and exchange offers must remain open for a minimum of twenty business days from the time the tender offer or exchange is first published or sent

[110] In *Southland Corp.*, the debtor not only decided to solicit only "registered" holders, but provided a solicitation period of only twelve or thirteen days. It was, therefore, easy for the court to determine that numerous voting problems existed. *In re* Southland Corp., 124 B.R. 211, 227 (N.D. Tex. 1991). Furthermore, in *In re* Pioneer Finance Corp., 246 B.R. 626, 632 (Bankr. D. Nev. 2000), in addition to failing to solicit the "beneficial" bondholders, the court held that the consents received by the debtor were insufficient acceptances of the plan because they merely amounted to an agreement to consent to some plan in the future.

[111] *See* FED. R. BANKR. P. 3017(e) (requiring court to "determine the adequacy of the procedures for transmitting the [solicitation materials] to beneficial holders").

[112] FED. R. BANKR. P. 3018(b).

to securityholders.[113] The minimum time for a proxy solicitation under the securities laws is only ten days.[114]

In *In re Southland Corp.*, however, the bankruptcy court, exercising its jurisdiction to approve and assure proper disclosure and solicitation, found the then-applicable securities laws standard of ten days to be "unreasonably short."[115] In making its determination, the court noted that although record owners had ten days, beneficial owners had at most only eight days to respond.[116] The court ordered resolicitation, according to the rules governing *post*petition solicitation, requiring a minimum of twenty-five days.

In planning for a prepackaged solicitation in which securities are held in street name, the best approach is to use the longest analogous period under the securities laws as a minimum, and make adjustments as appropriate depending on how widely the securities are held and the season.[117] It is advisable that a solicitation period should be at least thirty calendar days.

D. Registration Requirements[118]

Section 5 of the Securities Act prohibits the offer or sale of securities of an issuer unless either the securities have been registered with the SEC or an exemption from registration is available.[119] Section 1145 of the Bankruptcy Code provides such an exemption. The offer or sale of securities of a chapter 11 debtor[120] under a plan in exchange for claims against or interests in that debtor is exempt from registration. This exemption is available for all entities other than "underwriters."[121] Thus, except for underwriters, registration is not an issue in a traditional chapter 11 case.

[113] *See* 17 C.F.R. § 240.14e-1(a) (2005).

[114] Preliminary copies of the proxy statement and form of proxy, as well as any other soliciting material to be distributed at the time, must be filed with the SEC at least ten days before the final material is used unless the only matters at a securityholders' meeting are the election of directors and the selection of independent auditors. *See id*. § 240.14a-6(a).

[115] 124 B.R. 211, 227 (Bankr. N.D. Tex. 1991).

[116] *Id*.

[117] Twenty business days is at least twenty-six calendar days (assuming the solicitation commences on a Monday and there are no intervening holidays), and can be as long as thirty-two calendar days.

[118] For a further discussion of the security laws issues implicated in prepackaged chapter 11 cases.

[119] § 5, 15 U.S.C. § 77e. Various state "blue sky" laws provide similar restrictions.

[120] The exemption also applies to securities offered by an affiliate of the chapter 11 debtor that is participating in a joint plan with the debtor or a successor to the debtor under a chapter 11 plan. *See* 11 U.S.C. § 1145(a)(1).

[121] Section 1145(b)(1) of the Bankruptcy Code provides that an entity is an "underwriter" if it:

Notwithstanding the clear mandate of the statute, a member of the SEC staff has taken the position that the § 1145 exemption does not apply in the context of a prepackaged case.[122] The position is based on a technical interpretation of when the offer and sale of the securities are deemed to occur. According to the SEC, both the offer and the sale of the securities occur prior to the commencement of the chapter 11 case. The offer takes place at the time the disclosure statement is distributed and the sale occurs at the time the holders of the security vote for the plan (*i.e.*, at the time those holders make the investment decision to accept the new securities to be issued under the plan).[123] Since no chapter 11 case has been filed at that time, the SEC argues that § 1145 does not apply.[124]

The response to the SEC is that the contingencies inherent in the prepackaged chapter 11 process are so significant that the solicitation of votes on a plan at a stage predating the bankruptcy process is far too premature to constitute a meaningful offer to sell securities. These contingencies include the failure to obtain sufficient votes to accept the plan, a determination by the company not to commence a chapter 11 case, the failure to receive bankruptcy court approval of the disclosure statement, a modification of the plan which requires a resolicitation,[125] the failure of the bankruptcy court to confirm the plan, the reversal of the confirmation order on appeal, and the nonoccurrence of a condition precedent to the effectiveness of the plan.[126]

> purchases a claim against, interest in, or claim for an administrative expense in the case concerning, the debtor, if such purchase is with a view to distribution of any security received or to be received in exchange for such a claim or interest; offers to sell securities offered or sold under the plan from the holders of such securities; offers to buy securities offered or sold under the plan from the holders of such securities, if such offer to buy is with a view to distribution of such securities; and under an agreement made in connection with the plan, with the consummation of the plan, or with the offer or sale of securities under the plan; or is an issuer, as used in [§ 2(11) of the Securities Act], with respect to such securities.

11 U.S.C. § 1145(b)(1).

[122] *See* Abigail Arms, *Current Issues and Rulemaking Projects*, *in* CONDUCTING DUE DILIGENCE 1996, at 747, 871 (PLI Corp. L. & Prac. Course Handbook Series No. B4-7131, 1996); *see also* Timothy R. Pohl et. al., *Out of Court Restructuring and Prepackaged Plans*, *in* DEALING WITH SECURED CLAIMS & STRUCTURED FINANCIAL PRODUCTS IN BANKRUPTCY CASES, at 443-44 (PLI Comm. L. & Prac. Course Handbook Series No. A0-00HP, 2003); Ball & Greene, *supra* note 104, at 225-26.

[123] Arms, *supra* note 136, at 747, 871.

[124] A related argument is that § 1145 exempts only the offer and sale of securities *of a debtor*. Prior to the commencement of the chapter 11 case, the prospective issuer of the new securities is not a debtor under chapter 11.

[125] A resolicitation will be required if the plan modification is material and the existing disclosure statement does not sufficiently describe the plan, as amended. *See* 11 U.S.C. § 1127(c).

[126] Pohl, *supra* note 136, at 443-44; Ball & Greene, *supra* note 104, at 226.

However, because the point of a prepackaged chapter 11 case is to avoid litigation and controversy, the prudent course is either to register the offer and sale or to seek another exemption from registration. The disadvantage of registration is that it is a costly undertaking which usually adds at least six weeks to the process.[127] The advantage, however, is that it avoids the restrictions inherent in the exemptions from registration found in section 3 of the Securities Act.[128]

The most commonly used exemption is found in section 3(a)(9) of the Securities Act, which exempts the exchange of any security "by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange."[129] Generally, the exemption provided by section 3(a)(9) is available for the exchange of new securities for old securities of the same issuer,[130] as long as the security holders are not required to provide additional consideration[131] and no party will be compensated in any way for the solicitation. Unless an unrelated third party is issuing its securities to fund a plan, the last requirement is the most significant in the context of a prepackaged chapter 11 case.

An assessment of the "no remuneration" requirement necessarily focuses on who will be communicating with holders of the debtor's securities, the nature of the communications, and the nature of any compensation being paid. For example, it is certainly permissible for the company, through its employees, to solicit the exchange,

[127] The SEC is required to provide initial comments on filed registration materials within ten days. Securities Act § 8(b), 15 U.S.C. § 77h(b). It usually takes another two weeks for the company to respond to the comments and for the SEC to declare the registration effective. However, the process of resolving the SEC's comments can take much longer, depending on the financial state of the company and whether its debt is privately held.

[128] 15 U.S.C. § 77c.

[129] 15 U.S.C. 77c(a)(9).

[130] The SEC also has taken the position that the exemption is available in cases where the new securities are being offered by certain parties related to the issuer. *See, e.g.*, Equitable Life Assurance Soc'y, SEC No-Action Letter, 2004 WL 2646611 (SEC) (Nov. 15, 2004) (parent guarantor of securities of wholly-owned subsidiary treated as issuer for purposes of availing itself of the exemption); SunTrust Banks, Inc., SEC No-Action Letter, 1999 WL 506640 (SEC) (July 16, 1999) (exemption applied to special purpose subsidiaries formed solely to exchange securities of the parent where the parent has guaranteed the subsidiaries obligations with respect to such securities); Attwoods PLC, SEC No-Action Letter, [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,653 (Jan. 28, 1991) (parent exchanging new securities for those of a subsidiary where parent had previously guaranteed the subsidiary's dividends and redemptions); Mr. Coffee, Inc., SEC No-Action Letter, 1991 WL 178808 (SEC) (June 6, 1991) (successor corporation exchanging new securities for those of a predecessor); IMCO Realty Servs., Inc. SEC No-Action Letter, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,434 (Feb. 6, 1990) (guarantor of securities exchanging its securities for those of the entity whose obligation was guaranteed).

[131] *See* 17 C.F.R. 230.149 (2005) (providing the definition of "exchange" for purposes of the § 3(a)(9) exemption).

even though the employees receive a salary.[132] Communications between third parties, such as financial advisors, accountants, and attorneys hired by the debtor and holders of the debtor's securities also are permissible as long as the nature of the communications are limited.[133] However, the payment of a fee to any party based on the success of the solicitation raises the inference that the party has an incentive to carry on communications that would constitute a solicitation.

E. CLASSIFICATION OF CLAIMS

Dissenters may attack a prepackaged plan on the grounds that it improperly classifies claims.[134] One of the features of a prepackaged plan may be a requirement of support by trade creditors during the prefiling negotiation process, which can be gained only by assuring trade creditors that they will receive full payment (be rendered "unimpaired") under the plan. To accomplish this, the prepackaged plan usually creates a separate class for trade creditors. Since these are unsecured creditors, other unsecured creditors that have been classified into a separate class (such as public debtholders) and treated differently under the plan could claim that the plan contains improper classifications. A similar argument could arise whenever similarly situated creditors are classified separately and given different treatment under a plan.

Increasingly, the reported cases reflect a willingness to allow separate classifications of similar claims, as long as the classifications are reasonable and necessary to a successful reorganization.[135] Separate classifications cannot be used simply to manipulate class voting.[136] Because this is not a bright-line test, prepackaged

[132] However, the answer becomes less certain if the employees' duties are exclusively related to the solicitation (e.g., the employee was hired for that purpose).

[133] For example, it would be permissible for the debtor's financial advisor to respond to questions from securityholders by directing their attention to the responsive portions of the registration materials.

[134] Section 1122 of the Bankruptcy Code seeks to insure that when a class votes on a plan of reorganization, all members of that class have similar interests so that the class vote will affect all the parties similarly. To achieve this, the Bankruptcy Code prohibits the classification of disparate types of claims into the same class. Conversely, however, the Bankruptcy Code is silent on whether similar claims can be classified separately.

[135] *See, e.g.*, *In re* Dow Corning Corp., 280 F.3d 648, 662 (6th Cir. 2002); Aetna Cas. & Sur. Co. v. Clerk, U.S. Bankr. Court, New York, NY (*In re* Chateaugay Corp.), 89 F.3d 942 (2d Cir. 1996); Hanson v. First State Bank, 828 F.2d 1310 (8th Cir. 1987); *In re* Jersey Med. Ctr., 817 F.2d 1055 (3d Cir. 1987); *In re* LaFayette Hotel P'ship, 227 B.R. 445, 449 (S.D.N.Y. 1998); *In re* Exide Techs., 303 B.R. 48, 78 (Bankr. D. Del. 2003); *In re* Richard Buick, Inc., 126 B.R. 840, (Bankr. E.D. Pa. 1991). *But see In re* National/Northway L.P., 279 B.R. 17 (Bankr. D. Mass. 2002) (general unsecured claims must be classified together); *In re* Stoneridge Apartments, 125 B.R. 794, 796 (Bankr. W.D. Mo. 1991) (similar claims may not be classified separately); *In re* Valrico Square Ltd. Partnership, 113 B.R. 794, 795 (Bankr. S.D. Fla. 1990) (same).

[136] *Hanson*, 828 F.2d at 1313; *In re* Snyders Drug Stores, Inc, 307 B.R. 889, 893 (Bankr. N.D. Ohio 2004); *In re* Caldwell, 76 B.R. 643 (Bankr. E.D. Tenn. 1987).

plans with separate classifications may receive special scrutiny by the court. If the classes are found to violate § 1122, the prepackaged plan cannot be confirmed.

F. TREATMENT

A claim is considered impaired if a plan proposes to alter the legal, equitable, or contractual rights of the holder.[137] It is important for a prepackaged plan proponent to take particular care in classifying claims so that the classification cannot be attacked by dissidents. Case law indicates that even the "slightest" change in a holder's rights can create impairment.[138] Impairment has been found when excess collateral is surrendered,[139] when voting rights are altered,[140] and even when a financially stronger guarantor was substituted.[141]

Some plan proponents, in order to effect a reorganization under the cramdown provisions of the Bankruptcy Code, have attempted to use a tactic known as "intentional impairment." By separately classifying and "artificially" impairing one class of unsecured claims (such as by offering a ninety-nine percent recovery in order to obtain one class's affirmative vote on the plan) the proponent can cram down a plan on dissenters.[142]

Although a plan proponent has considerable flexibility in classifying claims, courts generally have frowned on "creative classification"; that is, classification for the purpose of gerrymandering votes.[143] Other courts have been more liberal in allowing artificial impairment when it was found necessary for an effective reorganization.[144] The uncertainty in the law as to impairment may make any prepackaged plan that uses intentional impairment vulnerable to challenge by dissidents.

Furthermore, as mentioned above, prepackaged plans often separately classify trade creditors for purposes of leaving such claims unimpaired. However, in the context

[137] 11 U.S.C. § 1124.

[138] *See, e.g.*, *In re* PPI Enters., 324 F.3d 197, 202 (3d Cir. 2003); *In re* Coram Healthcare Corp., 315 B.R. 321, 351 (Bankr. D. Del. 2004); *In re* Wilhelm, 101 B.R. 120 (Bankr. W.D. Mo. 1989); *In re* Solar King Corp., 90 B.R. 808 (Bankr. W.D. Tex. 1988).

[139] *See In re* Elijah, 41 B.R. 348 (Bankr. W.D. Mo. 1984).

[140] *See* Acequia, Inc. v. Clinton (*In re* Acequia, Inc.), 787 F.2d 1352 (9th Cir. 1986).

[141] *See In re* Barrington Oaks Gen. Partnership, 15 B.R. 952 (Bankr. D. Utah 1981).

[142] *See* 11 U.S.C. § 1129(b)(1).

[143] *See, e.g.*, *In re* Combustion Eng'g, Inc., 391 F.3d 190, 242-45 (3d Cir. 2004); Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (*In re* Greystone III Joint Venture), 995 F.2d 1274 (5th Cir.), *cert. denied*, 506 U.S. 821 (1992); Granada Wines, Inc. v. New England Teamsters & Trucking Ind. Pension Fund, 748 F.2d 42 (1st Cir. 1984).

[144] *See, e.g.*, Aetna Cas. & Sur. Co. v. Clerk, U.S. Bankr. Court, New York, NY (*In re* Chateaugay Corp.), 89 F.3d 942 (2d Cir. 1996); Hanson v. First State Bank, 828 F.2d 1310 (8th Cir. 1987).

of a cramdown, such separate classification and treatment may give a plan opponent the additional argument that the plan "unfairly discriminates" against other unsecured creditors that are not being paid in full.[145] Although § 1129(b)(1) of the Bankruptcy Code does not completely prohibit discrimination between similarly situated creditors, such discrimination must not rise to the level of "unfair discrimination."[146]

G. FEASIBILITY

One of the key requirements for the confirmation of a plan of reorganization is that it is "not likely to be followed by the liquidation, or the need for further financial reorganization" of the debtor unless that liquidation or reorganization is part of the plan.[147] This is known as the "feasibility requirement."

In order to expedite a prepackaged chapter 11 case, the proponent of a prepackaged plan has certain incentives to allow as many contingent or unliquidated claims as possible to "roll" or "pass" through bankruptcy—i.e., continue unimpaired, and therefore, be enforceable after reorganization. This avoids the need to liquidate the claim or obtain the claimant's acceptance of the prepackaged plan. Undetermined environmental liabilities are an example of such claims. If, however, too many contingent or unliquidated claims remain after reorganization, a dissident might argue that the debtor's future operations will be undermined and there will be a need for a further reorganization. If a court agrees, the plan will fail to meet the feasibility requirement. Accordingly, the proponent must gauge carefully the extent to which claims intentionally are allowed to roll or pass through unaffected by the reorganization. A debtor must balance the need to minimize the time spent on claims determination while maximizing the amount of liabilities that are discharged under the plan.

[145] *See* 11 U.S.C. § 1129(b)(1).

[146] *See id.; see also In re* Aztec Co., 107 B.R. 585, 590 (Bankr. M.D. Tenn. 1989) (setting forth four factors courts should consider when determining whether a plan unfairly discriminates against similarly situated creditors, including "(1) whether the discrimination is supported by a reasonable basis; (2) whether the debtor can confirm and consummate a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) the treatment of the classes discriminated against"). *But see In re* 203 N. LaSalle St., L.P., 190 B.R. 567, 585-86 (Bankr. N.D. Ill. 1995) (rejecting the factors applied in *Aztec*, and instead, considering whether the discrimination is "supported by a legally acceptable rationale" and whether the "extent of the discrimination [is] necessary in light of the rationale"), *aff'd sub nom.* Bank of Am., Ill. v. 203 N. LaSalle St. P'ship, 195 B.R. 692 (N.D. Ill. 1996), *aff'd sub nom. In re* 203 N. LaSalle St. P'ship, 126 F.3d 955 (7th Cir. 1997), *rev'd on other grounds sub nom.* Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434 (1999); *In re* Lernout & Hauspie Speech Prods., N.V., 301 B.R. 651, 661 (Bankr. D. Del. 2003) (adopting a modified test "which gives rise to a rebuttable presumption that a plan is unfairly discriminatory . . . where there is (1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution") (citing *In re* Dow Corning Corp., 244 B.R. 696, 702 (Bankr. E.D. Mich. 1999)).

[147] *See* 11 U.S.C. § 1129(a)(11).

IX. THE RISKS

The decision to commence negotiations on a prepackaged chapter 11 case largely is a one-way street into bankruptcy court. If all goes well, the debtor may enjoy the express train and reorganize quickly. If one of any number of obstacles proves insurmountable, the debtor may find itself in a protracted bankruptcy case.

A. CLAIMS TRADING

Claims trading has increased dramatically during the last 20 years. As a result, the dynamics of prepackaging a chapter 11 case have shifted. When a company's debt is in the hands of a stable group of creditors, negotiating and gaining acceptance of a prepackaged plan can be undertaken. By contrast, if the debt is actively traded, these negotiations become difficult, if not impossible. Moreover, even if the debt is held by a stable group during the period that a plan is negotiated, that plan can unravel rapidly if creditors subsequently sell their claims prior to the formal vote on the plan (unless the purchasers are locked into the seller's acceptances). For these reasons, a successful prepackaged chapter 11 case depends on having a creditor body that is committed to the plan and willing to restrict the ability to sell and transfer claims.

For example, in the case of *Marvel Entertainment Group, Inc.*,[148] the company commenced a prearranged chapter 11 case with the support of its secured creditors, obtained lockup agreements, and filed a plan of reorganization and disclosure statement at the outset of the case. Thereafter, the claims against the debtor's parent began to trade significantly as distressed-debt traders acquired them for the purpose of gaining control of the operating debtor and proposing a competing plan. The case rapidly became highly litigious and the prepackaging unraveled. As a consequence, the case went into freefall.[149]

By contrast, the chapter 11 cases involving PSF Finance L.P./Premium Standard Farms, Inc.,[150] took a completely different route. There, a consensual plan was agreed to by the companies' creditors, lockup agreements were signed, and the case was commenced with the filing of both the petitions and the plan and disclosure statement. The holders of Premium Standard Farms's debt were committed to remaining creditors of the debtors over the longer term, and only minimal amounts of debt changed hands. As a consequence, the debtors proceeded expeditiously through the formal solicitation and voting process, and the plan was confirmed some three months after the commencement of the case. However, with the continued growth in the trading of distressed debt claims,

[148] *In re* Marvel Entertainment Group, Inc., Nos. 96-2069 through -2077 (HSB) (Bankr. D. Del. 1996).

[149] *See also* Marcus Montgomery Wolfson & Burten P.C. v. AM Int'l, Inc. (*In re* AM Int'l, Inc.), 203 B.R. 898 (D. Del. 1996) (reporting that an equity committee "broke through" prepackaged plan to force a renegotiation of the plan in chapter 11).

[150] *In re* PSF Fin. L.P./Premium Standard Farms, Inc., Nos. 96-1032 through -1036 (HSB) (Bankr. D. Del. 1996).

the ability to complete such a successful prepackaged chapter 11 case may diminish in the future.

B. RISK OF INVOLUNTARY FILING

As a debtor negotiates a prepackaged plan with its creditors, disgruntled creditors may commence an involuntary case against the debtor as a way of increasing their leverage in negotiations. Contesting such a case will invariably distract the debtor from the prepackaging process and may prove fatal to a fragile consensus that had previously been formed with certain key creditors.[151] In addition, the involuntary petition may be filed in a jurisdiction that might be less desirable from the debtor's standpoint, giving the dissidents additional negotiating leverage and leaving the debtor in an unwelcome forum.[152]

C. "CIRCLING THE DRAIN"

Negotiations regarding a prepackaged chapter 11 case are unlikely to be kept confidential for long. The formal commencement of a prepackaged plan solicitation is tantamount to a public announcement that the debtor intends to commence a chapter 11 case in the very near future. As word of an impending filing spreads, trade creditors may hold up shipments until after the filing in order to obtain an administrative rather than prepetition claim. This could create a sudden illiquidity which forces the debtor to commence a hastily planned traditional case. Similarly, a consensus on a prepackaged plan may never materialize, and the debtor can be left with the tarred image of impending bankruptcy which is likely to become a self-fulfilling prophesy.

D. ADVERSE COURT RULINGS

Even if all goes well and a debtor commences a prepackaged chapter 11 case after reaching agreement with its key creditors, dissidents may nonetheless challenge the proposed plan on a variety of grounds. If adverse court rulings ensue, the prepackaged process can unravel rapidly, sometimes with dire consequences for the debtor.

[151] *See, e.g., In re* New Valley Corp., 168 B.R. 73, 74–75 (Bankr. D.N.J. 1994) (describing the fact that an involuntary case was filed against the debtor while it was attempting to prepackage; after receiving extensions of the time to answer for a year and a half, no consensus was reached and the debtor consented to entry of order for relief).

[152] *See In re* Flagstar Corp., No. 97-05104 (Bankr. D.S.C., June 17, 1997) (in order to preempt the debtor's proposed filing of the voluntary prepackaged case in Delaware, certain junior subordinated bondholders filed an involuntary chapter 11 case against the debtor in the District of South Carolina, twelve days after the debtor mailed a prospectus and ballot for voting on a prepackaged plan to creditors and equity holders). *But see In re* NRG Energy, Inc., 294 B.R. 71 (Bankr. D. Minn. 2003) (court abstained from hearing and dismissed the involuntary chapter 11 case filed against the debtor by its former executives and officers despite the possibility that the debtor ultimately may file for bankruptcy protection in another district if out-of-court negotiations with its creditors were unsuccessful).

For instance, in *Vista Del Mar Associates, Inc. v. West Coast Land Fund (In re Vista Del Mar Associates, Inc.)*,[153] a debtor filed a prepackaged chapter 11 case calling for a cash infusion from new investors and the completion of a real estate development project. At the hearing to consider approval of the disclosure statement, the court directed the debtor to make certain amendments. At a continued hearing, the court remained unsatisfied with the disclosure statement. At yet a further hearing, the court suggested that a disgruntled creditor file a competing plan and disclosure statement. The court then considered both disclosure statements, approved the one proposed by the creditor, and refused to approve the debtor's. As a consequence, the creditor's plan—which proposed an immediate auction of the debtor's principal asset—was approved and confirmed.

Another example of a disastrous setback for a debtor seeking to prepackage a chapter 11 case is seen in *In re Bellevue Place Associates*.[154] There, a debtor negotiated an agreement prepetition with one creditor giving that creditor virtually total control over the debtor's operations and entitling the creditor to act in its own best interests in the administration of the debtor's affairs. When a chapter 11 case was thereafter commenced, the court disqualified the creditor and its professionals from operating the company in bankruptcy, and appointed a chapter 11 trustee.

Furthermore, in *In re Scott Cable Communications, Inc.*,[155] the Internal Revenue Service objected to confirmation of the debtor's prepackaged liquidating chapter 11 plan on the grounds that the plan did not provide for the payment of any federal or state tax liability in connection with a sale of substantially all of the debtor's assets. The court denied confirmation of the debtor's prepackaged plan because it determined that the debtor's primary purpose in filing the plan was tax avoidance.

In *Marcus Montgomery Wolfson & Burten P.C. v. AM International, Inc. (In re AM International, Inc.)*,[156] the results were not disastrous for the debtor, but a streamlined prepackaged case was derailed. There, a debtor commenced a prepackaged chapter 11 case without reaching a consensus with the equityholders. An ad hoc committee then petitioned for its appointment as an official committee in order to attack the plan as proposed. The court granted the request, having been persuaded the debtor might not be insolvent. The ensuing litigation held up the progress of the reorganization until the debtor agreed to issue warrants to the equityholders.

An early prepackaged case discussed above, *In re Southland Corp.*,[157] came to serve as a warning to debtors about the pitfalls of the prepackaging process, a process which the court referred to as "Russian roulette." The debtor had commenced a fully

[153] 181 B.R. 422 (B.A.P. 9th Cir. 1995).

[154] 171 B.R. 615 (Bankr. N.D. Ill. 1994).

[155] 227 B.R. 596 (Bankr. D. Conn. 1998).

[156] 203 B.R. 898 (D. Del. 1996).

[157] 124 B.R. 211 (Bankr. N.D. Tex. 1991).

solicited, dual-track prepackaged chapter 11 case. After the commencement of the case, dissidents opposed confirmation by attacking the debtor's prepetition solicitation procedures. Although these procedures had complied fully with SEC requirements, the court found that the solicitation was deficient on several other grounds. The debtor had paid a solicitation agent a fee for all securities tendered, which the court found had created a conflicting interest. The debtor had solicited the votes of record holders, rather than beneficial holders, pursuant to the express terms of the rule which refers to the "holder of record" of the security. The court nonetheless found this improper and concluded that the rule was of no effect because it contravened the spirit of the Bankruptcy Code in that it contemplated voting by the creditor or the equity interest holder and not the record holder, which has no economic interest. In addition, the court found that the solicitation had been improper because creditors were not given enough time to respond, even though the time period had been sufficient under federal securities laws and approved by the SEC. Finally, the court criticized the manner in which the debtor counted votes. Based on all these factors, the court directed the debtor to undertake a complete resolicitation.

X. LOCAL GUIDELINES AND THE 2005 AMENDMENTS

A. GUIDELINES FOR PREPACKAGED CHAPTER 11 CASES

In an effort to facilitate uniformity of results and to avoid unnecessary litigation, a committee of judges, attorneys, court clerks, and the United States Trustee for the Southern District of New York established procedural guidelines for commencing and administering prepackaged chapter 11 cases filed in the United States Bankruptcy Court for the Southern District of New York.[158] The guidelines are purely advisory and are unique to the Southern District of New York. In particular, the guidelines provide direction with respect to prefiling notification to the United States Trustee and the court clerk,[159] the retention of professionals,[160] balloting and soliciting procedures,[161]

[158] On February 2, 1999, the Board of Judges for the Southern District of New York adopted General Order 201 (as amended on February 24, 1999 by General Order 203), which sets forth the prepackaged chapter 11 case guidelines.

[159] Pursuant to the guidelines, at least two business days prior to filing a prepackaged chapter 11 case, the debtor should notify the U.S. Trustee and the Clerk of the Court of its intention to file a prepackaged case, and provide to the U.S. Trustee copies of the debtor's plan and disclosure statement. If possible, the debtor also should provide drafts of all pleadings and corresponding proposed orders to be filed on the petition date (i.e. the "first day motions") at least one day prior to the filing of the case.

[160] Under the Guidelines, it is unnecessary for the debtor to retain, pursuant to § 327 of the Bankruptcy Code, accountants, investment advisors, vote tabulators, solicitation agents or similar nonlegal professionals that were retained by the debtor prepetition and are not seeking additional payments for services provided postpetition. Such nonlegal professionals may continue to provide nominal services, such as testifying at the debtor's confirmation hearing; however, if such professionals will be providing substantive services to the debtor, they must be retained pursuant to § 327 of the Bankruptcy Code.

[161] Among other things, the guidelines suggest that a reasonable time period for creditors or equity securityholders to cast their acceptances or rejections on the debtor's plan is (i) twenty business days from

disclosure regarding the prepackaged plan,[162] first day motions and orders,[163] creditors' committee meetings,[164] and notice requirements.[165] The guidelines also provide practitioners with sample forms customized for prepackaged chapter 11 cases.

B. BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

On April 20, 2005, the 2005 Amendments were enacted. The amendments have two important implications with respect to prepackaged chapter 11 cases. First, pursuant to the newly added § 341(e) of the Bankruptcy Code, the court, on the request of the debtor or another party in interest and after notice and a hearing, may order the United States Trustee to refrain from convening a meeting of creditors or equity security holders if the debtor has filed a plan and solicited acceptances of the plan prior to commencing the case. Second, previously, it was uncertain whether a debtor that began solicitation of its prepackaged bankruptcy plan prior to filing its petition could continue solicitation postpetition in the absence of a court approved disclosure statement. The new subsection eliminates this uncertainty and provides that "acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if such holder was solicited before the commencement of the case in a manner complying with applicable nonbankruptcy law."[166]

the commencement of the mailing of the ballots, in the case of publicly traded securities and all other claims or interests, or (ii) ten business days for securities which are not publicly traded or debt which is not evidenced by a publicly traded security. The guidelines also provide form ballots for both beneficial and record holders, as well as for other claims and interests, to be used in connection with a prepackaged plan solicitation.

[162] For example, the guidelines provide a form to be used to summarize the debtor's prepackaged plan of reorganization and to provide notice of the hearing to consider the adequacy of the disclosure statement and confirmation of the plan.

[163] The guidelines provide a list of the typical first day motions, including, but not limited to, (i) a motion setting the deadline for filing proofs of claims or interests, (ii) applications to employ appropriate professionals (i.e. attorneys, accountants, financial advisors), and (iii) a motion authorizing the debtor to obtain postpetition financing.

[164] For instance, pursuant to the guidelines, a statutory committee of unsecured creditors generally will not be appointed where the unsecured creditors are unimpaired under the debtor's prepackaged plan.

[165] The guidelines set forth specifications with respect to the contents of the notice to be given to creditors regarding the filing of the debtor's prepackaged plan and disclosure statement and the hearings to consider the adequacy of the disclosure statement and confirmation of the plan. For example, the notice of the disclosure statement and confirmation hearing must (i) set forth the date, time, and place of the hearing and the date and time by which objections to the foregoing must be filed and served, (ii) include a chart summarizing distributions under the plan, (iii) set forth the name, address, and telephone number of the person from whom copies of the plan and disclosure statement can be obtained (at the debtor's expense), and (iv) state that the plan and disclosure statement can be viewed electronically and explain briefly how electronic access to these documents may be obtained.

[166] 11 U.S.C. § 1125(g).

XI. CONCLUSION

Use of the prepackaged or prenegotiated format often is desirable and in the best interests of all parties. It avoids the entrapping minutia of the chapter 11 process that often impedes the achievement of reorganization. Yet one must proceed cautiously and avoid the pitfalls of poor planning. The proponent must evaluate the creditor body, the debtor's business, the nature of the liabilities, the potential for litigation for and against the debtor and other persons, the attitude of the particular court, and consequences of possible conversion to a traditional chapter 11, before commencing the prepackaged chapter 11 process.