New York Law Journal

WWW.NYLJ.COM
An ALM Publication
VOLUME 246—NO. 118
TUESDAY, DECEMBER 20, 2011

Outside Counsel

Expert Analysis

Law of Unintended Consequences: Competing Plans in Post-BAPCPA World

By **Damian S. Schaible**

And **Eli J. Vonnegut**

Before the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), indefinite extensions of a debtor's initial 120-day exclusive period in which to file a plan were commonly granted, making competing plans a rare occurrence. Judges could open the plan process for cause, but in practice they did so rarely. While many viewed debtor control of the plan process as helpful to case resolution (and judges that extended exclusivity presumably viewed it as the appropriate path), some felt it contributed to excessive delay and cost in the restructuring process.[1]

In an apparent attempt to address these concerns, a BAPCPA provision now codified as Section 1121(d)(2)(A) of the Bankruptcy Code imposed an unalterable 18-month outside limit on a debtor's plan exclusivity (allowing an additional two months to obtain plan approval). The goals of this inflexible rule seem self-evident: faster reorganizations, reduced administrative burden and costs, and stronger motivations for parties to achieve a swift, consensual resolution. Recent experience with competing plans in large cases, however, raises the question of whether a fixed cap on exclusivity is the best means of achieving these goals.

Competing Plans Pre-BAPCPA

"Cause" under the pre-BAPCPA version of Section 1121(d) was not clearly defined in the legislative record or the Bankruptcy Code itself,[2] but over time courts developed nine key considerations to be weighed in deciding whether to extend exclusivity: (i) the size and complexity of the case; (ii) the necessity for sufficient time to permit the debtor to negotiate a plan of reorganization and prepare adequate information; (iii) the existence of good faith progress toward reorganization; (iv) whether the debtor was paying its bills as they became due; (v) whether the debtor had demonstrated reasonable prospects for filing a viable plan; (vi) whether the debtor had made progress in negotiations with its creditors; (vii) the amount of time that had elapsed in the case; (viii) whether the debtor was seeking an extension of exclusivity in order to pressure creditors to submit to the debtor's reorganization demands; and (ix) whether an unresolved contingency existed.[3] Although these factors were often weighed together, the overarching consideration for courts seems to have been whether granting an extension would ultimately aid in the efficient and fair reorganization of the debtor.[4]

Under this standard, larger debtors facing more complex negotiations were generally more likely to receive numerous exclusivity extensions.[5] Size and complexity, however, did not always yield endless exclusivity—cases like *TCI 2 Holdings, LLC* [6] and *Young Broadcasting Inc.*,[7] for instance, provide examples of debtors losing exclusivity notwithstanding significant size and complexity, where the bankruptcy court believed that exclusivity no longer provided the most constructive path to resolution.[8] In *TCI 2 Holdings*, the court terminated exclusivity after parties in interest argued that the debtors had mismanaged the reorganization process, wasting time and money, and noted that two feasible competing plans had already been prepared.[9] In *Young Broadcasting*, the Bankruptcy Court was swayed by the existence and potential merit of a proposed competing plan and decided both the debtors' plan and the competing plan should be distributed for a creditor vote.[10]

Post-BAPCPA World

Under new Section 1121, the bankruptcy court retains discretion to extend debtor exclusivity up to the 18-month cap, but thereafter the court cannot impose any limitation on the ability of any party in interest to file a plan.

In the pending *Tribune* Chapter 11 cases, after support collapsed for the plan initially filed by the debtors, exclusivity expired in early August 2010. A court-appointed mediator worked to generate support for a single plan, but when it became clear that these efforts would fail, the bankruptcy court established a schedule for the filing of competing plans and the consideration of disclosure statements, all leading to a simultaneous solicitation of all competing plans. Four plans were ultimately filed, each reflecting a different proposed resolution (or plan for litigation) of the claims related to Tribune's 2007 LBO. *In re Tribune Company*, Case No. 08-13141, Dec. 9, 2010 (KJC) [D.I. 7126] (with an amended Solicitation Order entered on Dec. 16, 2010 as D.I. 7215, reflecting the withdrawal of the SOCAL Plan, which was one of the competing plans).

In what may become a model for competing plan processes post-BAPCPA, Judge Kevin Carey ordered the debtors and the other competing parties to develop a core "General Disclosure Statement" about the debtors, their businesses and prospects. He then ordered each plan proponent group to develop a "Specific Disclosure Statement" describing its proposed plan. In order to resolve some of the tension between advocacy and factual disclosure in the solicitation materials, ultimately each group was allowed to also write and distribute a "Responsive Statement," which did not bear the court's imprimatur and allowed each group to argue the merits of its plan and the flaws of the other plans. In all, the disclosure package sent to creditors exceeded 29,000 pages, even after withdrawal of one of the four plans.

In the *Lehman Brothers* case, widely acknowledged as among the most complex cases ever filed, the debtors filed an unfinished plan in March 2010 on the last day of the 18-month maximum exclusivity period and later filed several amendments. After the expiration of exclusivity, creditors filed two additional plans, each taking a different approach, favoring different creditor groups. The proponents of the competing plans initially sought to have their disclosure statements approved on the same timeline as the disclosure statement for the debtors' plan. *In re Lehman Brothers Holdings Inc.*, Case No.

DAMIAN S. SCHAIBLE *is a partner and* ELI J. VONNEGUT *is an associate in the insolvency and restructuing group at Davis Polk & Wardwell.* PETER KIM, *an associate at the firm, assisted in the preparation of this article.*

08-13555, Aug. 30, 2011 (JMP) [D.I. 19579].

The debtors objected, arguing that the court should use its power to manage its docket to "sequence" competing plans, permitting solicitation of votes on the debtors' plan to proceed first, followed by the other plans only if the debtors' plan failed. After preliminary skirmishing on the sequencing point and several postponements of the disclosure statement hearing, the competing plan proponents agreed that in exchange for certain modifications to the debtors' plan, their plans would be held in abeyance while solicitation proceeded for the debtors' plan.

Implementing 18-Month Cap

Practical Challenges. Absent from the legislation enacting the new 18-month cap is any procedural guidance as to its implementation. Once exclusivity expires, the Code fails to prescribe how competing plans should be filed and considered—serially or simultaneously—or how the disclosure and solicitation process should be managed. Unlike the pre-BAPCPA era, when the right to file a competing plan was frequently only granted selectively (such as in the *Young Broadcasting* case, where only a specific competing plan was permitted to be filed), there is at least in theory no limit on how many plans may be filed once the 18-month cap is reached in a case, and no guidance for courts on how to retain control of the proceedings.

While 1121(d)(2)(A) may have been intended to expedite case resolution and increase creditor choice, in practice there is a risk that creditors may be flooded with numerous plans and a huge volume of complex information they have neither the time nor the sophistication to digest. Distribution of a single, coordinated disclosure package (as in the *Tribune* case) could reduce administrative burden and voter confusion, yet the complexity and expense of any such undertaking increases exponentially with the number of warring factions involved. No matter how well-coordinated the process, in multi-plan cases, sheer volume of information could ultimately render any attempt at effective disclosure futile.

Because of the lack of legislative guidance on these procedural issues, the judges in the *Tribune* and *Lehman Brothers* bankruptcies had to "fill in the blanks" as they deemed appropriate. Experience in these cases, in which relatively manageable numbers and types of competing plans were filed, has shown that there is a risk that competing plan processes may exacerbate rather than mitigate the issues of cost, confusion and time, if not handled properly. It is easy to imagine higher numbers of competing plans being filed in even more contentious or disorderly cases, and in those circumstances it is unclear whether the limited authority given to judges to manage the process would be sufficient.

Problematic Incentives. As noted above, limiting exclusivity appears to have been intended to motivate a debtor and its creditors to craft a workable, consensual reorganization within the defined time limit. With respect to creditors and shareholders, however, there is at least a colorable argument that an inflexible rule actually has the opposite effect. Before the implementation of BAPCPA, plan exclusivity motivated non-debtor parties to work toward a broadly supported compromise in a debtor-led process, in line with the overriding philosophy of modern Chapter 11. Capping debtor exclusivity, however, might motivate creditors and shareholders attempting to improve their recoveries to wait out the fixed period, after which they will be free to attempt to take control of the plan process themselves. Competing plans may well be filed as a weapon in a battle for value, rather than as a means of peaceful case resolution. Although this dynamic may not be present in every case, section 1121(d)(2)(A) renders judges unable to address the problem where it may be evident.

Conclusion

When compared to past practice, the key change occasioned by new section 1121(d)(2)(A) is that the presiding judge can no longer assess the state of play and leave the debtor in control of the plan process or limit the number of parties authorized to file competing plans, even if he or she decides that doing so would be the most efficient means of resolving the case at hand. In an extreme scenario, a judge could not extend exclusivity even if he or she thought that opening the plan process would be tremendously counterproductive. One cannot escape the clear inconsistency between the implication of this rule—that after 18 months, the judgment of the court is no longer relevant—and other portions of the Code that grant judges wide latitude and expressly rely on them to properly referee the process so as to most effectively shepherd the reorganization.

Section 1121(d)(2)(A) divests judges of their previous flexibility in favor of a general, inflexible, hard-and-fast rule.

Exclusivity unquestionably gives the debtor significant leverage in plan negotiations, and arguments related to exclusivity tend to hinge on whether one views this leverage as a good or bad thing. This abstract question, however, is not really the right question to ask when assessing the new 1121(d)(2)(A). The question raised more directly is who is best situated to decide whether debtors should be given the leverage that exclusivity offers. The pre-BAPCPA regime acknowledged that what will most effectively push a case forward varies from case to case, and thus let the presiding judge decide. The hard cap takes this valuable case management tool away from judges. Recent experience with competing plans raises a real question as to whether an unyielding restriction, divorced from the specifics of a case as viewed by the presiding judge, is appropriate.

Although exclusivity puts debtors firmly in control of the plan process, even pre-BAPCPA negotiations were driven by a process that first and foremost requires certain levels of creditor support and therefore a certain amount of creditor input; in other words, exclusivity gave debtors some leverage, but creditors were by no means powerless. Perhaps most importantly, if continuing to allow the debtor to control the process became inefficient or unworkable at any time, the pre-BAPCPA regime allowed a judge to lift exclusivity, and to do so either completely or for a specific competing plan offering a different approach to the reorganization. Section 1121(d)(2)(A) divests judges of their previous flexibility in favor of a general, inflexible, hard-and-fast rule. It remains to be seen whether this important shift will have unintended consequences more harmful to the process than the perceived ills it was presumably intended to cure.

1. *In re Public Service Company of New Hampshire*, 88 B.R. 521, 540 (Bankr. D. New Hampshire 1988) ("Delay is not only costly in terms of administrative expenses but it could also be damaging to the prospects of realizing the intrinsic economic value of the [debtor's assets].")

2. *In re Express One International, Inc.*, 194 B.R. 98, 100 (Bankr. E.D. Texas 1996).

3. *In re Adelphia Communications Corp.*, 352 B.R. 578, 586 (Bankr. S.D.N.Y. 2006); *In re Express One International, Inc.*, 194 B.R. 98 (Bankr. E.D. Texas 1996); *In re Grand Traverse Development Co., Ltd.*, 147 B.R. 418 (Bankr. W.D. Mich. 1992); *In re Wisconsin Barge Line, Inc.*, 78 B.R. 946 (Bankr. E.D.Mo. 1987).

4. *In re Dow Corning Corporation*, 208 B.R. 661, 670 ("When the Court is determining whether to terminate a debtor's exclusivity, the primary consideration should be whether or not doing so would facilitate moving the case forward. *And that is a practical call that can override a mere toting up of the factors.*") (emphasis added).

5. *In re Express One International, Inc.*, 194 B.R. 98, 100 (Bankr. E.D. Texas 1996).

6. 428 B.R. 117 (Bankr. D. N.J. 2010).

7. *In re Young Broadcasting Inc., et al.*, Case No. 09-10645, April 19, 2010 (AJG) [D.I. 907].

8. See also, *In re Public Service Company of New Hampshire*, 88 B.R. 521, 537 (Bankr. D. New Hampshire 1988) ("…size and complexity must be accompanied by other factors pertinent to the particular debtor and its reorganization to justify extension of plan exclusivity…. Such factors include those developed in the cases, i.e., the likelihood of an imminent consensual plan if the debtor retains control, no alternate substantial plan being held off by debtor exclusivity, and the general balancing analysis to avoid allowing the debtor to hold the creditors and other parties in interest 'hostage' so that the debtor can force its view of an appropriate plan upon the other parties.")

9. *In re TCI 2 Holdings*, LLC, Case No. 09-13654 (JHW), (Bankr. D. N.J. 2009) [D.I. 613].

10. *In re Public Service Company of New Hampshire*, 88 B.R. 521, 537 (Bankr. D. New Hampshire 1988) ("The court concludes that…size and complexity must be accompanied by other factors pertinent to the particular debtor and its reorganization to justify extension of plan exclusivity…. Such factors include those developed in the cases, i.e., the likelihood of an imminent consensual plan if the debtor retains control, no alternate substantial plan being held off by debtor exclusivity, and the general balancing analysis to avoid allowing the debtor to hold the creditors and other parties in interest 'hostage' so that the debtor can force its view of an appropriate plan upon the other parties.")

Reprinted with permission from the December 20, 2011 edition of the NEW YORK LAW JOURNAL © 2011 ALM Media Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382 or reprints@alm.com. # 070-12-11-32