Assessing the Impact of the New Chapter 11 Exclusivity Deadline

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Mark G. Douglas

A debtor's exclusive right to formulate and solicit acceptances for a plan of reorganization during the initial stages of a chapter 11 case is one of the most important benefits conferred under the Bankruptcy Code as a means of facilitating the successful restructuring of an ailing enterprise. By giving a chapter 11 debtor-in-possession time to devise a solution to balance sheet and operational problems without being burdened by the competing agendas of other stakeholders in the bankruptcy case, exclusivity levels the playing field, at least temporarily.

Even so, exclusivity is flexible, reflecting the recognition that in some cases, a debtor's sole right to control the plan process should be extended, while in others, it should be abridged. In most large chapter 11 cases, extensions of exclusivity have become the norm — a practice that has been criticized because of the perception that giving a debtor exclusive control of the plan process for an extended period (in some cases years) is unproductive and unfair. Responding to concerns that debtors' reliance on exclusivity unduly prolongs chapter 11 cases, Congress amended the Bankruptcy Code in 2005 to place an outside limitation on exclusivity. At this juncture, what impact the new rule will have on the progress of chapter 11 cases remains to be seen. Recent developments, however, suggest that bankruptcy courts are casting a more critical eye on exclusivity extension motions, even short of the new time limitation, particularly in cases where progress toward a negotiated exit plan is less than satisfactory.

Chapter 11 Exclusivity

Upon the commencement of a chapter 11 case, Bankruptcy Code section 1121 gives a debtor-in-possession ("DIP") the exclusive right to file a plan of reorganization for 120 days. The DIP also has the exclusive right to solicit acceptances (votes) for a plan filed within that 120-day period until 180 days after filing for chapter 11. No competing plans may be filed during this period of exclusivity.

The concept of limited exclusivity in the Bankruptcy Code was based upon a compromise. Under the corporate reorganization provisions of U.S. bankruptcy law pre-dating the enactment of the current statute in 1978, only the debtor had the right to propose a plan. Armed with exclusivity throughout the case, a debtor could hold creditors hostage to its own reorganization agenda and threaten to convert to a liquidating case if creditors were reluctant to do so. Lawmakers attempted to remove what was considered to be undue bargaining leverage when they enacted the Bankruptcy Code.

Congress recognized, however, that eliminating exclusivity altogether would be ill-advised. It might remove the incentive of existing management — which is often crucial to the debtor's reorganization prospects — to manage the debtor during the chapter 11 case because disaffected creditors or shareholders could file a plan at any time to bring in new owners and dislodge it. The absence of exclusivity, and the prospect of one or more competing plans filed at the inception of a case, could also lead to chaos. Recognizing the utility of permitting a DIP to act as an "honest broker" for a negotiated solution during the initial stages of a case, Congress opted for limited exclusivity in section 1121.

"Limited" exclusivity means that the time frame is flexible and may terminate upon the occurrence of certain specified conditions. Among these are the appointment of a trustee and the

debtor's failure to file a plan or obtain acceptance of a plan by the requisite majorities of all impaired classes of claims and interests within the exclusive periods. If any of these occur, any party-in-interest in the bankruptcy case, "including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee," has the right to file its own plan of reorganization.

Exclusivity is also flexible because it may be modified. Bankruptcy Code section 1121 gives the bankruptcy court the discretion to either extend or reduce the exclusive periods upon a showing of "cause." The Bankruptcy Code does not define "cause." Courts have fashioned their own definitions, based upon the legislative purpose underlying section 1121 and the practical realities of chapter 11 cases, where it may be unrealistic to suppose that the debtor can turn its attention to formulating, negotiating and winning acceptance of a plan within the 120- and 180-day periods specified in the statute. Over the years, courts have developed a variety of factors, each of which, standing alone, may provide sufficient justification for extending the exclusive periods. These factors include:

- the size and complexity of the case;
- the necessity of sufficient time to negotiate and prepare adequate information;
- the existence of good faith progress toward reorganization;
- whether the debtor is paying its debts as they come due;
- whether the debtor has demonstrated reasonable prospects for filing a viable plan;
- whether the debtor has made progress in negotiating with creditors;
- the length of time the case has been pending;

- whether the debtor is seeking the extension to pressure creditors; and
- whether unresolved contingencies exist.

Bankruptcy courts are given wide latitude to evaluate whichever factors apply in any given case and to give them appropriate weight in determining whether to extend exclusivity.

New "Drop Dead" Date for Exclusivity

Congress made important changes to section 1121 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. As amended, the statute provides that the 120-day period during which the DIP has the exclusive right to file a chapter 11 plan "may not be extended beyond a date that is 18 months" after the bankruptcy petition date. In addition, the 180-day period during which only the DIP may solicit votes for a plan may not be extended beyond 20 months after the filing date. The amendment was prompted by a widespread perception that some debtors were languishing in chapter 11 for inordinate periods of time, and that a more abbreviated time-frame for exclusivity will encourage debtors and other stakeholders to come to the table sooner for the purpose of negotiating a viable exit strategy, which will ultimately reduce administrative costs.

The immediate impact of the new "drop-dead" date for chapter 11 exclusivity has been difficult to gauge thus far. Because the 18-month period applies only to cases filed on or after October 17, 2005, no chapter 11 debtor will confront the deadline until the middle of April 2007. Even so, anecdotal evidence and filing statistics indicate that the new rule already figures prominently in pre-chapter 11 strategic planning. A substantial number of companies filed for chapter 11 before October 17, 2005 to avoid being subject to the 18-month deadline (as well as other aspects of the amendments). In addition, the volume of "pre-packaged" or pre-negotiated

chapter 11 cases has been on the upsurge, suggesting that potential chapter 11 debtors are increasingly striking deals with creditors and other stakeholders in advance of a bankruptcy filing as a way to avoid losing control of the negotiating process.

Moreover, the "feet to the fire" mentality underlying the changes may lead bankruptcy courts to examine exclusivity extension requests with stricter scrutiny, even in cases where the new deadline does not apply. For example, Judge Jerry A. Brown of the United States Bankruptcy Court for the Eastern District of Louisiana, who is presiding over the chapter 11 case of the utility Entergy New Orleans Inc., terminated the debtor's exclusivity on December 8, 2006. Entergy, which filed for chapter 11 protection on September 23, 2005 due to losses stemming from hurricane Katrina, did not file a plan of reorganization until more than a year after seeking chapter 11 protection, and had been granted two extensions of exclusivity. In granting the motion filed by Entergy's unsecured creditors' committee, Judge Brown expressed a desire to speed up negotiations on a plan, noting that professional fees in the case were averaging $1.8 million each quarter. He ruled that any party-in-interest (including Entergy) that wanted to submit a plan of reorganization in the case had to do so by December 19, 2006. Entergy and its unsecured creditors' committee submitted competing plans of reorganization before the deadline.

Prepackaged and Pre-Negotiated Chapter 11 Cases
Filed and Confirmed Post Effective Date of BAPCPA

Company	*Assets*	*Filed*	*Confirmed*
ABB Lummus Global, Inc.	$414,039,169	4/21/06	6/16/06
Blue Bird Body Co	$346,777,000	1/26/06	1/27/06
Curative Health Services, Inc	$283,784,000	3/27/06	5/22/06
Davis Offshore LP	$69,336,438	3/07/06	3/10/06
Inland Fiber Group, LLC	$84,775,000	8/18/06	11/09/06
Integrated Electrical Services, Inc.	$416,372,000	2/14/06	4/26/06

McLeodUSA Incorporated	$1,025,800,000	10/28/05	12/16/05
Oneida Ltd.	$328,812,000	3/19/06	8/30/06
Pliant Corporation	$777,092,000	1/03/06	6/23/06
Satelites Mexicanos, S.A. de C.V.	$925,271,000	8/11/06	10/26/06
Silicon Graphics, Inc.	$452,145,000	5/08/06	9/19/06