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The Quickie Bankruptcy

More Companies Enter Court, and Exit, in a Flash

By MIKE SPECTOR

For executives at lender CIT Group Inc., filing for bankruptcy seemed like a death sentence. No financial firm had survived a Chapter 11 process.

But after cajoling from advisers, CIT filed a "prepackaged" bankruptcy-restructuring plan supported by an overwhelming number of bondholders. The firm entered court Nov. 1 and sped through Chapter 11 in 40 days, emerging Dec. 10 after eliminating $10.5 billion in debt.

CIT's case capped a year that rewrote the playbook on long-established bankruptcy practices, as cases moved through court in record times. Unlike traditional bankruptcy filings, which can plod on for years, the restructurings have aimed to get lenders' consent ahead of time or bypass creditor scrutiny altogether.

In 2009, the number of prearranged bankruptcies, in which many creditors approve a reorganization plan ahead of a filing, tripled to 30 among public companies, according to BankruptcyData.com. In other cases, most notably the government-brokered restructurings of Detroit auto makers General Motors Corp. and Chrysler LLC, companies quickly sold assets out of bankruptcy to restart businesses with new owners. The deals are called "363 sales," named after the relevant part of the bankruptcy code.

Not all bankruptcies have shunned the traditional process. Some in the field worry that the speedy bankruptcies have amounted to short-term fixes of balance sheets without addressing core operational issues.

Many wonder whether companies such as Chrysler Group LLC, as the company now is called, will survive. Steven Rattner, who headed President Barack Obama's auto task force, recently wrote that the decision to save Chrysler was a close call.

Yet with 2009 as precedent, these quicker restructurings are poised to become the preferred method to fix debt-laden companies.

The strategies of quick sales and prearranged bankruptcy deals are "being used more creatively and more expansively to accomplish restructurings faster than ever before," said Richard Levin, a bankruptcy lawyer at Cravath, Swaine & Moore LLP who helped write the modern bankruptcy code in 1978.

A "prearranged" plan secures most, if not all, creditor support before a bankruptcy filing. Bankruptcy professionals call these plans "prepackaged" if enough creditors support the deal ahead of time to meet the legal threshold for a court's approval. Quick 363 sales, by contrast, can move nearly all key assets to a new buyer in lieu of a formal reorganization plan.

Such 363 sales were used to restructure retailer Eddie Bauer Holdings Inc., while prearranged deals sped other firms from every corner of the economy through Chapter 11, including door maker Masonite International Corp., auto-parts maker Lear Corp. and Lazy Days RV Center. The restructurings took only weeks or a few months.

In December, Citadel Broadcasting Corp. filed for bankruptcy protection in a prearranged deal with lenders and said it hopes for an "expeditious" restructuring.

The ability of companies to speed through Chapter 11 could hit roadblocks this year. Improving markets embolden junior creditors to fight for better value for their claims, which can complicate negotiations ahead of a filing or prompt litigation in court that slows down cases.

For firms in dire financial straits, the quick, surgical bankruptcy process has become the preferred way to stay alive. In the GM and Chrysler cases, creditors complained that quick sales were disguised reorganization plans that dodged requirements for creditors' scrutiny.

And many on Wall Street groaned that rules requiring that secured lenders get paid ahead of unsecured creditors were trampled. In Chrysler, holders of secured bank debt received 29 cents on the dollar for claims, while the United Auto Workers union, an unsecured creditor, received a 55% stake in the reorganized Chrysler.

But a congressional oversight panel found that the president's auto task force used the bankruptcy code appropriately.

Matthew Feldman, the auto task force's bankruptcy lawyer, recalled that officials were enamored with the 363 sale strategy because it could allow the auto makers to shed more liabilities and get through Chapter 11 fast with fewer legal challenges.

"I don't think there was any question in any of our minds how this would work," said Mr. Feldman, who has since returned to law firm Willkie Farr & Gallagher.

Still, such quick restructurings worry some bankruptcy professionals.

"Because they're not taking the time to fix these companies and just reshuffling the deck in the capital structure, you're just poised to see these things back in bankruptcy," said William Snyder, a managing partner at CRG Partners who worked on the restructuring of chicken company Pilgrim's Pride. Pilgrim's fell into bankruptcy protection in December 2008 and spent the next year closing plants and rejecting contracts. It also used the time to develop a reorganization plan that resulted in Brazilian beef company JBS SA buying 64% of its stock. The plan paid off creditors in full and left some recovery for shareholders.

The debate over quick restructurings has prompted legal scholars to explore possible overhauls to the bankruptcy code. "Traditional reorganizations under Chapter 11 are in many ways a vestige of a bygone era," said Richard Chesley, a restructuring lawyer at Paul, Hastings, Janofsky & Walker LLP.

At CIT, executives were persuaded over a couple of months to gamble on the largest prepackaged bankruptcy in history.

As CIT neared collapse in July, bondholders stepped in with $3 billion in rescue financing. The bondholders, which included private investment firms Centerbridge Partners LP, Oaktree Capital Management LP and Capital Research & Management, pushed for a condition: CIT had to present them a suitable restructuring plan by Oct. 1.

Over the next two months, divisions formed over the best course. Some advisers pushed CIT to ask bondholders holding $31 billion in debt to participate in a debt exchange, trading debt for new secured debt maturing later with longer maturities.

But others, including Evercore Partners Inc.'s David Ying and Jeffrey Werbalowsky, a Houlihan Lokey banker representing the rescue lenders, warned that bondholders with near-term maturities would "hold out" in the hopes CIT would be able to pay them in full. That would prevent CIT from trimming enough debt from its balance sheet, prolonging its pain, advisers warned.

These advisers recommended that CIT try a prepackaged bankruptcy. One reason: Once in court, dissident bondholders could be forced to agree to the restructuring plan so long as CIT received enough support from other lenders.

That would allow CIT to eliminate about a third of its bond debt and push out maturities. And with enough creditors on board, a plan could be confirmed by a judge quickly. Mr. Ying and Gregg Galardi, a lawyer at Skadden, Arps, Slate, Meagher & Flom, helped convince regulators that CIT could survive a quick Chapter 11 case. It worked.

"Even I, who was one of the chief proponents of a bankruptcy process, was astonished we came out of bankruptcy so quickly and with so little contention," said Mr. Werbalowsky.

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