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FINANCIAL FALL OUT

BANKRUPTCY COULD BE THE ANSWER TO FINANCIAL WOES

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Guest contributor

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As the number of financially distressed Houston companies grows, particularly in the upstream energy industry, managers of distressed businesses are well advised to plan ahead. In most cases, it's best to pursue an orderly process to identify strategic restructuring alternatives, well in advance of a bankruptcy filing, to avoid the brinksmanship, litigation and costs associated with a free-fall Chapter 11 bankruptcy.

Chapter 11 cases can be very different depending on the circumstances, parties and issues involved. The process leading up to a court-approved reorganization or liquidation can vary drastically depending on numerous factors including whether the case is prepackaged, prearranged or free-fall.

A prepackaged bankruptcy case is one in which the plan has been formulated, negotiated and solicited before the bankruptcy filing. Such cases are more transactional in nature and confirmation of such plans can occur in weeks or even days. Prepackaged cases were common during the wave of restructuring that stemmed from the 2014 oil price collapse and typically involve refinancing and debt-for-equity swaps that do not impair trade creditors.

A prearranged case involves the negotiation of a Chapter 11 plan with certain of its key creditors before the filing of the case, but votes are solicited with respect to each class of creditors after the filing. If the prearranged plan is confirmed as proposed, the post-filing process will be materially longer than a prepackaged case, typically two or more months.

Conversely, a traditional – or free-fall – case involves a bankruptcy without significant negotiations regarding a plan of reorganization. The plan must be formulated, filed and solicited during the course of the case and can take months or years to complete. Although there are circumstances in which a free-fall bankruptcy is the best option, such filings are almost always more contentious and expensive than those in which a debtor is able to build a pre-filing consensus toward a particular restructuring path.

The costs associated with Chapter 11 can be staggering. A sophisticated debtor will typically rely on a number of professional advisors with different skill sets to help navigate the restructuring process. These can include a general bankruptcy counsel, other special counsel, ordinary course professionals, a financial advisor, and investment banker. These and other post-filing costs must be paid to confirm a plan. Often, the largest constituencies, including secured lenders and the committee of unsecured creditors, will also require attorneys, financial advisors and investment bankers. The costs of these advisors are often born by the debtor.

Ultimately, the value of the assets and business, combined with other unique issues, will drive the restructuring strategy. Notably, bankruptcy is a litigation-oriented process. Accordingly, if a company fails to lock up support from key constituencies, those creditors are more likely to employ litigation options that can drastically increase legal fees and costs.

Recent Chapter 11 cases filed by upstream oil and gas companies and the prolonged dip in commodity prices, suggest that free-fall bankruptcies in the upstream oil and gas space may be on the rise. Depending on the circumstances, such cases can be more expensive, can negatively affect the company's business and make it more difficult for the company to reorganize.

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