GLOBAL INSIGHT
News, Views and Analysis from DLA Piper's Global Restructuring Group

THE CHANGING PROFILE OF LARGE CHAPTER 11 CASES

FTI CONSULTING

Most restructuring professionals would readily acknowledge that these are rather lean times for formal corporate restructurings and a challenging environment for the profession at large. Events of corporate debt defaults and large bankruptcies have been at lackluster levels for the better part of the last two years. S&P's speculative-grade debt default rate finished 2013 at a cyclical low of just under 2% – less than one-half its long-term average – while the number of large corporate chapter 11 filings fell by 18% last year. Capital markets continue to bestow their largess on risky corporate borrowers, including many at the lower end of the ratings spectrum. But a closer, more focused look at the statistical data underlying these events, especially in comparison to the previous cyclical expansion, reveals a more nuanced story.

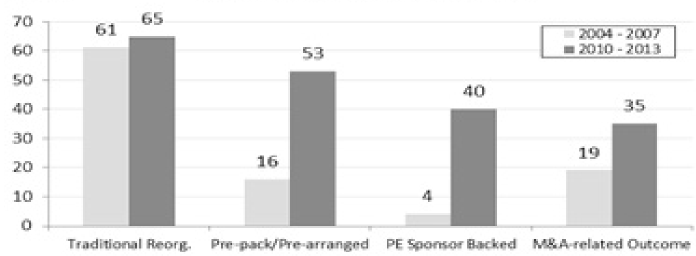
In fact, we found that the number of large chapter 11 filings over the last four years far exceeds accumulated totals in 2004-2007, the comparable prior period of economic expansion (see Exhibit 1). We noted 165 large chapter 11 filings in 2010-2013 compared to 91 in 2004-2007, of which 118 and 77, respectively, have emerged from bankruptcy. (Note that 22 of 47 large cases that filed in 2013 are still pending resolution.) What is strikingly different when we compare summary statistics from these two periods is the duration and characteristics of these chapter 11 cases. Average case lengths in 2010-2013 fell by approximately one-half compared to the 2004-2007 period, with 45% of large chapter 11 cases emerging within 120 days of filing compared to just 17% for the previous period.

The sharp decline in case lengths is mostly attributable to the larger proportion of case filings considered to be pre-negotiated/pre-arranged or pre-packaged chapter 11 filings in the most recent four-year period. Some 45% of large filings were categorized as such compared to 21% in 2004-2007. The average duration of these "pre" cases was 107 days, a significantly lower figure than a traditional reorganization without a pre-negotiated plan.

Analysis of Large Chapter 11 Cases
(>$250mm in assets or liabilities at filing)

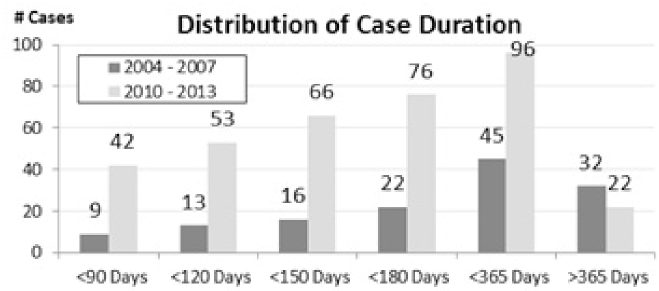
	2004 - 2007	2010 - 2013
Case Characteristics:		
Chapter 11 Cases Filed	91	165
Emerged/Reorganized	77	118

Select Case Characteristics



	2004 - 2007	2010 - 2013
Case Duration:		
Average (in days)	439	210
Median (in days)	320	136
Traditional Reorg. (in days)	524	294
Pre-pack/Pre-arranged (in days)	116	107

Distribution of Case Duration



Source: S&P's Capital IQ and The Deal

In turn, the larger proportion of pre-negotiated plans is at least partially attributable to the higher percentage of chapter 11 reorganizations involving PE sponsored companies, which tend to feature deleveraging recapitalizations rather than long, protracted operational overhauls. About one-third of large chapter 11 filings involved a PE backed company compared to 5% in 2004-2007. Moreover, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 has also contributed to shorter case lengths by limiting a debtor's maximum exclusivity period to file a plan of reorganization to 18 months after the petition date. Average case lengths for large chapter 11 filings that didn't feature any sort of pre-negotiated plan also fell sharply in the 2010-2013 period.

So what does it all mean? Despite perceptions to the contrary, corporate workout and restructuring activity, while certainly not robust in any sense, is considerably more active than it was during the previous cycle of credit expansion. But today's large reorganizations are distinctly different from those that preceded the 2008 financial crisis. Primarily, they don't take nearly as long to consummate even though case sizes are not appreciably different in the two periods we evaluated. More than ever, irrespective of case size or complexity, there is a prevailing sense of urgency among debtors and creditors alike to navigate the bankruptcy process as expeditiously as possible—while financing remains available and affordable, while M&A solutions remain viable and while the business backdrop is benign. The fragility of market conditions and the post-crisis realization that these windows of opportunity can change abruptly and unexpectedly arguably serves to discourage obstructionist behavior, foot-dragging or other needless delay among self-interested constituents to a large case.

We are reminded of this new dynamic by two cases in which we are advising. Cengage Learning, Inc. was a $7 billion buyout in 2007 that filed for chapter 11 relief in July 2013 amid persistently softer end markets for educational materials and curricula and budget cutbacks in education departments across the country since the recession. The debtor listed nearly $10 billion of total liabilities upon filing. The Cengage case is also complex, with first and second lien debt, unsecured notes, substantial crossholdings and a legal structure involving various holdco and intermediate holdco entities. Nonetheless, there was significant negotiation with large creditors over a plan of reorganization ahead of the chapter 11 filing and it was widely hoped this would be a fast track reorganization. That scenario didn't materialize but by early February a fifth amended POR and disclosure statement had received the informal support of all major creditor classes and up to $2 billion of exit financing was being arranged. Formal solicitation of creditors is expected to begin soon. All in all, that's an impressive accomplishment within less than eight months for a case of this size and complexity.

Hostess Brands, Inc. is another case that demonstrates how quickly events can move these days in bankruptcy. After a four-year stint in bankruptcy, Hostess Brands (fka Interstate Bakeries) emerged in 2009 only to file again for chapter 11 relief in early 2012 amid an unsupportable capital structure and chronically weak operating results. Despite its financial struggles, Hostess Brands was still a $2.5 billion business with a stable of renowned brand names. It filed a motion for an orderly wind down in mid-November 2012 amid a crippling strike by its bakers' union, which was granted late that month. Operating assets were shut down and prepared for sale in December 2012, and a spirited auction sale of the Hostess Brands business began in early 2013. The auction process of Hostess's main brands and businesses was completed by mid-April with $860 million in winning bids, an amount that easily exceeded most expectations and eventually provided for a full recovery to first and second lien creditors. The timeline from the wind down order to the completion of the auction sale was a little over four months, with some ancillary assets sold later, a remarkably short period to accomplish so much.

For restructuring professionals, these case trends represent an ongoing challenge to meet—they provide convincing evidence that large, complex companies can reorganize relatively quickly via the chapter 11 process but compress the timeline to accomplish so much without compromising the reorganization effort or jeopardizing the optimal case outcome.

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