The Prepackaged Bankruptcy Strategy

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This Practice Note provides an overview of the prepackaged bankruptcy process, including how "prepacks" are implemented, when they are most useful, and their advantages and disadvantages relative to traditional Chapter 11 bankruptcy cases and out-of-court restructurings. This Note also provides links to summaries of the local rules for prepacks in certain jurisdictions, allowing attorneys to compare rules across different bankruptcy courts.

Prepackaged bankruptcies, typically known as "prepacks," allow a company to emerge more quickly and efficiently from bankruptcy, while reducing the risks and uncertainties involved with negotiating a traditional **plan of reorganization** during bankruptcy proceedings.

This Note discusses the prepack process, including:

- How it is implemented.
- When it is most useful.
- Its advantages and disadvantages relative to traditional **Chapter 11** bankruptcy cases and **out-of-court restructurings**.
- How its use has been affected by the **Bankruptcy Abuse Prevention and Consumer Protection Act of 2005** (BAPCPA).
- Its various stages.
- Potential challenges.

What is a Prepack?

A prepackaged bankruptcy is a Chapter 11 bankruptcy in which the debtor negotiates the terms of and solicits votes on a plan of reorganization before it files its Chapter 11 bankruptcy petition. In theory, the case is "prepackaged" because all debtor-creditor and intercreditor disputes are resolved and all necessary votes are solicited before the debtor files its bankruptcy petition. Ideally, only the procedural steps required to **confirm** the plan remain in the bankruptcy proceeding.

The purpose of a prepack is to use the bankruptcy process to implement an out-of-court restructuring agreement between a debtor and its major creditors. Unlike traditional Chapter 11 cases, prepacks are generally not used to restructure a debtor's business operations. Instead, they are more appropriate for restructuring the financial debt on a debtor's **balance sheet**, with non-financial **claims** (such as those of trade vendors or employees) typically being paid in full and otherwise legally unaffected by the bankruptcy.

A successful prepack is faster and more efficient than a traditional Chapter 11 case. Unlike an out-of-court restructuring, it can bind non-consenting creditors (see Benefits of Prepacks). However, a prepackaged plan must still comply with all of the same requirements for plan confirmation as a traditional Chapter 11 plan (see Plan Approval).

For a typical timeline of the prepack process, see Timeline of a Prepackaged Bankruptcy Case.

Companies can also use other pre-bankruptcy tactics to facilitate restructurings (see Box, Other Pre-Bankruptcy Tactics).

Prepack Techniques

Prepacks can be implemented in the following ways:

- Prepacks combined with an exchange offer (see Prepacks Combined with an Exchange Offer).
- Partial prepacks (see Partial Prepacks).
- Full prepacks (see Full Prepacks).

Prepacks Combined with an Exchange Offer

Both prepacks and exchange offers are typically used to restructure publicly-held debt (see Best Conditions for a Prepack). In a conventional exchange offer, the company is **deleveraged** and/or offers new debt or **equitysecurities** with lower **interest rates** and/or longer **maturities** to replace outstanding **debt securities** with higher interest rates and/or near-term maturities (see Practice Note, Out-of-Court Restructurings: Overview: Exchange Offers).

Often for an exchange offer to be successful, the holders of 90% to 95% of each class of security solicited must voluntarily accept the company's offer. Therefore, the company may also separately solicit votes on a prepackaged plan (which may have different terms from the exchange offer), hoping that the threat of bankruptcy will induce creditors to tender into the exchange offer.

If the company does not obtain sufficient tenders for the exchange offer but receives enough votes to confirm a Chapter 11 bankruptcy plan (at least two-thirds in dollar amount and more than one-half in number of claims actually voting in each **class** (§ 1126(c), Bankruptcy Code)), it can file for bankruptcy protection with its prepackaged plan (a "stapled prepack"). All creditors, including those not consenting to the exchange offer ("holdouts"), are bound by the terms of a confirmed prepackaged plan. This creates an incentive for holdouts to participate in the exchange offer, especially if it provides more favorable treatment than the prepack.

Partial Prepacks

In a partial prepack, the debtor solicits the votes of only certain classes before it files its bankruptcy petition and solicits votes from the remaining classes **postpetition**. Partial prepacks are permissible if substantially all parties within the **prepetition** solicited class were solicited and given sufficient time to vote on the plan (Fed. R. Bankr. P. 3018(b)). This allows for at least some streamlining of the case if it is not possible for the debtor to obtain all of the necessary votes to confirm the

plan before a **liquidity** crisis forces it to file for bankruptcy or it elects to file for bankruptcy for a strategic reason, such as avoiding an upcoming interest payment.

Alternatively, a debtor may strategically opt not to solicit all necessary votes prepetition. For example, it may solicit classes not receiving securities under the plan prepetition and classes receiving securities under the plan on a postpetition basis. For those classes receiving plan securities, the debtor may wait until after it has filed the bankruptcy petition so it can take advantage of the **Bankruptcy Code's** exemption from registration for securities offered under a plan (§ 1145(a), Bankruptcy Code and see Nature of Disclosure).

Full Prepacks

Full prepacks are restructurings conducted solely through a prepackaged plan, without first attempting an exchange offer. Sometimes, the problem of holdouts in exchange offers may not justify the additional time, complexity, and risk of combining an exchange offer with a prepack. Also, unlike a partial prepack, a debtor using a full prepack solicits and obtains all of the votes required to confirm its prepackaged plan before it files for bankruptcy.

Best Conditions for a Prepack

Prepacks are not an effective solution for all distressed companies. They work best for companies suffering from an overleveraged capital structure that are not plagued by operational issues or bad management. In practice, prepacks are most successful where:

- There is strong creditor support, which is easiest to obtain when the debtor only has to negotiate with a **trustee** or a committee representing a limited number of sophisticated creditors.
- The claims of those creditors do not fluctuate (such as the claims of holders of **debentures** and bonds).
- The debt being restructured is private, which avoids the need to comply with US federal and state securities laws, as it is uncertain whether the exemption from the securities laws in section 1145 of the Bankruptcy Code applies to a prepetition solicitation of votes in a prepack (see Nature of Disclosure).
- The debtor has sufficient liquidity to fund the prepetition preparation process involved in a prepack (see Prepetition: Disclosure and Solicitation).

If the debt is fairly concentrated, it is easier to reach the terms of an agreement with a sufficient number of creditors holding the requisite amount of debt before filing for bankruptcy. Prepacks are also more likely to succeed in this situation if **unsecured creditors** (such as trade vendors, employees, and landlords) are **unimpaired** by the prepack (§ 1124(1), Bankruptcy Code and see Practice Note, Reinstatement of Prepetition Loans in Bankruptcy: What is Impairment?). Unimpaired creditors are deemed to have accepted the plan and are not entitled to vote (§ 1126(f), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Who Can Vote on a Plan?). Therefore, this eliminates a class of creditors who could potentially block confirmation of the plan.

Challenging Conditions for a Prepack

In contrast, prepacks are less suitable for companies with an unorganized and diverse creditor base who are unrepresented by a trustee or committee. These creditors hold a variety of claims entitled to different treatment under the Bankruptcy Code, the amounts of which may also fluctuate substantially before the bankruptcy filing (for example, trade and employee claims). In this situation it is more difficult to negotiate plan terms and obtain votes from enough creditors to satisfy plan confirmation requirements (see Practice Note, Chapter 11 Plan Process: Overview: Required Votes). In particular, prepacks may be less appropriate for companies with significant:

- **Numbers of contingent claims or unliquidated liabilities.** The allowability and estimation of these types of claims and liabilities (for example, product liability claims and environmental claims) are often time-consuming matters resolved by the bankruptcy court. However, the nature of a prepack requires these issues to be resolved before access to the bankruptcy court is available. Also, if the holders of these claims are dispersed, it may be too difficult for the debtor to identify them to comply with the requirement that the plan be distributed to substantially all members of a particular class (Fed. R. Bankr. P. 3018(b) and see Solicitation Procedures).

- **Reliance on trade credit.** It is crucial for companies that heavily rely on **trade credit** or customer deposits to maintain strong business relationships and good communication with their vendors, suppliers, customers, and other third parties. If these parties lose confidence and refuse to continue dealing with the company on normal trade terms while it is negotiating and soliciting the prepack, the company may run out of cash before it can complete the prepack, forcing it to make a traditional Chapter 11 filing.

- **Operational issues.** The speed of a prepack does not allow a company requiring substantial operational restructuring enough time in bankruptcy to fully take advantage of the tools available to it under the Bankruptcy Code to address operational problems while being protected by the **automatic stay** (see Disadvantages Relative to Traditional Chapter 11 Cases and Practice Note, Bankruptcy: Overview of the Chapter 11 Process: Powers, Protections and Advantages of Chapter 11). These tools include the ability to:
    - reject burdensome **executory contracts** and leases (see Practice Note, Executory Contracts and Leases: Overview);
    - enter into asset sales where the buyer acquires exceptionally clean title (see Practice Note, Buying Assets in a Section 363 Sale: Overview);
    - modify or terminate pension liabilities (see Practice Note, Retirement Plans in Bankruptcy); and
    - **avoidpreferences** and **fraudulent transfers** (see Practice Notes, Preferential Transfers: Overview and Strategies for Lenders and Other Creditors and Fraudulent Conveyances in Bankruptcy: Overview).

Benefits of Prepacks

The advantages of prepacks are relative, depending on whether the alternative is a traditional Chapter 11 case or an out-of-court restructuring.

Advantages Over Traditional Chapter 11 Cases

Prepacks are generally less lengthy and costly than traditional Chapter 11 cases. There are also fewer risks and uncertainties in prepacks than those involved with negotiating a plan of reorganization during in-court bankruptcy proceedings. Further, by filing a prepack, a company may be in a better position to maintain employee and customer relationships and ultimately have a greater chance of a successful restructuring.

The main advantages of a prepack over a traditional Chapter 11 case are:

- **Speed and minimized disruption.** If the prepack is approved, a debtor can be out of bankruptcy in a matter of weeks or months. This lowers the costs (see below) and risks of the Chapter 11 process and minimizes disruption to its business. While a debtor is unlikely to emerge from a traditional Chapter 11 case in less than a year (and may take as long as two or three years (see Timeline of Chapter 11 Cases by Type)), it can typically emerge from a prepack in less than six months (generally 50 to 100 days) (see Timeline of a Prepackaged Bankruptcy Case). Courts have even confirmed some prepacks within 24 hours of the filing of the bankruptcy petition (see One-Day Chapter 11 Case Checklist).

- **Reduced costs.** Administrative costs (such as monthly operating reports and the costs involved with notice requirements) can be reduced with a prepack because less time is spent in bankruptcy (see above). Further, the **US Trustee** often declines to appoint a **creditors' committee**, which results in additional cost savings (see Postpetition: The Chapter 11 Case). These cost savings, however, should not be overstated because the debtor also incurs substantial professional fees and expenses in negotiating with creditors before filing for bankruptcy (and it typically pays for the fees and expenses of the advisors to an *ad hoc* committee, without the benefit of the bankruptcy court's oversight on the reasonableness of those fees).

- **Retaining employees.** Because the prepack process is shorter and less uncertain than traditional Chapter 11 bankruptcy, the debtor is more likely to retain its best employees and more easily attract new senior management talent, to the extent that is necessary. Prepacks also help preserve employee morale because the debtor can provide employees with more information on how they will be treated in the restructuring, thereby gaining their cooperation and support.

- **Communicating with customers and vendors; preserving confidence.** The less time the debtor spends in bankruptcy, the easier it is to control communications with customers and vendors and the less likely that a competitor will use the bankruptcy as an opportunity to steal the company's market share. Prepacks also help preserve customer and vendor confidence because the debtor can provide these constituents with greater clarity on how they will be treated in the restructuring, thereby gaining their cooperation and support.

- **Greater control and certainty.** The debtor has more control over the **reorganization** process in a prepack than in a traditional bankruptcy, as the plan is finalized before the debtor submits to the jurisdiction of the bankruptcy court. Minimizing the amount of time in bankruptcy results in less court and creditor second-guessing and supervision over management decisions. Also, because the prepack process is relatively consensual as compared to a traditional Chapter 11 case, there is less chance that:
    - the creditors would force the debtor to replace members of its senior management;
    - the debtor's **exclusivity** period to file a plan would either expire before the prepack process is complete or be terminated for cause by the bankruptcy court (see Practice Note, Chapter 11 Plan Process: Who May File a Plan?);
    - the court would appoint an **examiner** or **trustee** (see Practice Notes, Chapter 11 Examiners and Appointing or Electing a Chapter 11 Trustee); and
    - the court would **convert** the case to **Chapter 7** or dismiss it completely (see Practice Note, Dismissing or Converting a Chapter 11 Case to a Chapter 7 Case).
- **Higher probability of success.** Execution risk is reduced if the deal is highly consensual, with most key creditors supporting the plan. Unlike a traditional Chapter 11 case, in a prepack the debtor has already solicited the votes necessary to confirm its plan before it has even filed for bankruptcy (see Prepetition: Disclosure and Solicitation).
- **Availability of financing.** It is generally easier to obtain **DIP financing** in a prepack than in a traditional Chapter 11 case because the risk that the debtor will fail to emerge from bankruptcy as a viable entity is reduced (see above). This is a concern for lenders who consider extending financing to a Chapter 11 debtor (see Practice Note, DIP Financing: Overview: Risk of Failure or Liquidation). It may also be easier for the debtor to obtain **exit financing** because sometimes DIP financings extended in prepacks have been convertible into exit financings. Exit financings are typically harder to obtain than DIP financings because exit lenders do not have the same easy access to the bankruptcy court if the debtor defaults (see Practice Note, Exit Financing: Overview).
- **Preserving privacy and public image.** The less time spent in bankruptcy, the less the debtor is subject to increased public scrutiny. Chapter 11 is a public and transparent process. It is potentially stigmatizing and may damage the public's confidence in the company. Spending less time in bankruptcy is especially beneficial to companies that are concerned with their public image (for example, manufacturers).
- **Less litigation.** Much of the protracted litigation with creditors typical in traditional large Chapter 11 cases is avoided because the prepack process is relatively consensual. This allows management more time to focus on running the business rather than being distracted by discovery requests.

Advantages Over Out-of-Court Restructurings

Relative to an out-of-court restructuring, it may be easier for a debtor to use a prepack to bind all of the various constituents to its plan of reorganization, particularly where there are many classes of debt and equity or many security holders. Prepacks also offer a variety of protections to the debtor that are not available in an out-of-court workout.

Binding Dissenters

A confirmed prepack binds dissenters and holdouts who could block an out-of-court restructuring. In contrast, an out-of-court restructuring only binds those creditors who consented to the deal. Companies often coerce creditors into an out-of-court transaction by combining solicitation of a prepack with an exchange offer for similar or more favorable economic terms (see Prepack Techniques).

Majority Rule

As a corollary to the point above, the level of acceptance required for a prepack to succeed is much lower than that needed for a successful out-of-court restructuring. This is because not all:

- creditors must consent to a prepack, as only at least two-thirds in dollar amount and more than one-half in number of claims actually voting in each class must accept the prepackaged plan (§ 1126(c), Bankruptcy Code).

- classes must accept the prepackaged plan, as they may be **crammed down** if the plan meets certain requirements (§ 1129(b), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Confirmation of a Plan: Cramdown Plans). Sometimes the mere threat of a cramdown can be enough to get non-consenting parties to go along with a proposed plan. In contrast, a successful exchange offer often requires a 90% to 95% acceptance level.

Automatic Stay Protection

In the postpetition phase of a prepack, the automatic stay protects the debtor from those of its creditors opposed to the prepack (§ 362(a), Bankruptcy Code and see Practice Note, Automatic Stay: Overview: Prohibited Acts). This protection is not available in an out-of-court restructuring, where creditors who have not agreed to a forbearance are not barred from, among other things, exercising any remedies provided for in **loan documents** or engaging in informal collection activities.

Rejecting Executory Contracts and Leases

Although prepacks are not ideal for companies with operational issues because they do not spend enough time in bankruptcy to take advantage of its benefits (see Challenging Conditions for a Prepack), the short amount of time spent in bankruptcy allows for the opportunity to reject at least some burdensome contracts and leases (see Practice Note, Executory Contracts and Leases: Overview). This option is not available in an out-of-court restructuring.

Tax Advantages

Although the time spent in a prepack bankruptcy is short, it still allows the debtor to take advantage of certain US federal income tax benefits available to all Chapter 11 debtors, such as the ability to preserve **net operating loss** carryforwards (NOL carryforwards) and to exclude **cancellation of indebtedness income** from gross income (see Practice Note, Bankruptcy: Overview of the Chapter 11 Process: US Federal Income Tax Benefits).

Court-Ordered Releases

A plan approved by a bankruptcy court can contain significant court-ordered releases and exculpation provisions shielding non-debtor parties involved in negotiating the prepack, such as the debtor's officers and directors and members of the creditors' committee and their advisors (see Practice Note, Third-Party Releases in Bankruptcy Plans). This protection from possible legal challenges by non-consenting holdouts encourages creditor participation in the restructuring process. In contrast, participants in an out-of-court restructuring cannot obtain this court-ordered protection.

For more information on third-party releases, see Practice Note, Third-Party Releases in Bankruptcy Plans.

More Certainty About Original Issue Discount (OID)

An exchange offer carries the risk that if the company later files for bankruptcy, any unamortized **OID** created in the exchange of securities will be disallowed by a court as unmatured interest, which would reduce the total amount of the claim of a creditor receiving these securities (§ 502(b)(2), Bankruptcy Code and see Practice Note, Postpetition Interest, Fees, Costs, and Charges in Bankruptcy: Original Issue Discount Problem). This result may discourage creditors from participating in exchange offers. Although the US Court of Appeals for the Second Circuit has held that any new securities issued in a face value debt-for-debt exchange offer as part of a consensual workout does not create any new OID for the purpose of determining the amount of a creditor's claim in bankruptcy (see *Official Comm. of Unsecured Creditors of LTV Steel Co., Inc. v. Valley Fid. Bank & Trust Co. (In re Chateaugay Corp.)*, 961 F.2d 378, 383 (2d Cir. 1992) and the US Bankruptcy Court for the Southern District of New York ruled the same for fair market value debt-for-debt exchange offers (see *Official Comm. of Unsecured Creditors v. UMB Bank, N.A. (In re Residential Capital, LLC)*, 501 B.R. 549 (Bankr. S.D.N.Y. 2013) and Legal Update, In re Residential Capital: Unamortized OID Created by Fair Market Value Debt Exchange Allowed under Bankruptcy Code), another court outside of these jurisdictions may decide differently. In contrast, an exchange of debt securities through a confirmed Chapter 11 plan is generally protected under the Bankruptcy Code.

Potential Exemptions from Securities Laws

Although not completely settled under the law, it is possible that the Bankruptcy Code exempts certain securities issued under a prepackaged plan from the registration requirements of the **Securities Act of 1933, as amended** (Securities Act) (§ 1145(a), Bankruptcy Code and see Nature of Disclosure). It may also provide a safe harbor from the antifraud provisions of the securities laws which require good faith prepetition solicitation by the debtor to its prepetition creditors (§ 1125(e), Bankruptcy Code and see Solicitation Procedures). In contrast, these bankruptcy-related exemptions are not available in out-of-court restructurings.

Risks of Prepacks

The disadvantages of prepacks are relative, depending on whether the alternative is a traditional Chapter 11 case or an out-of-court restructuring.

Disadvantages Relative to Traditional Chapter 11 Cases

Prepacks, while on the rise, remain less common than traditional bankruptcies, as they are only appropriate when the parties can agree in advance on a restructuring solution, and this solution does not require resolving significant operational issues. Prepacks also involve certain risks that do not exist in traditional Chapter 11 cases and provide the debtor with less time to reevaluate and fine-tune its business plan.

The main disadvantages of a prepack relative to a traditional Chapter 11 case are:

- **Retroactive approval.** Unlike in a traditional Chapter 11 case, creditors vote on a prepackaged plan before the solicitation procedures and the **disclosure statement** are approved by the court (see Prepetition: Disclosure and Solicitation). Therefore, there is a risk the court may find these were inadequate under bankruptcy law standards (§ 1125(a), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Disclosure and Solicitation). In that case, the debtor must resolicit acceptances and repeat the entire process after remedying the inadequacies, causing delay and increasing costs.

- **Advance notice to creditors.** The nature of a prepack requires that the company give advance notice to its creditors that it intends to, or is seriously considering, seeking bankruptcy protection. This may result in some creditors acting preemptively against the company (for example, by **foreclosing** on **collateral**, restricting credit, or filing an **involuntary petition** (see Practice Note, The Involuntary Bankruptcy Process)) and generally gives creditors leverage.

- **Compliance with additional disclosure laws.** In a traditional Chapter 11 case, the debtor must only comply with bankruptcy law concerning disclosure (see Practice Note, Chapter 11 Plan Process: Adequacy of Disclosure). However, in a prepack, the debtor may need to comply with both bankruptcy and non-bankruptcy disclosure laws, if the plan includes an offer to buy or sell public securities (for example, state and federal securities laws, state corporate law, and the rules and regulations of the stock exchanges) (see Nature of Disclosure). Complying with the non-bankruptcy disclosure laws can be time-consuming and expensive.

- **Uncertain exemptions from securities laws.** It is unclear whether securities issued under a prepackaged plan are subject to the Bankruptcy Code's safe harbor concerning the registration of securities (§ 1145(a), Bankruptcy Code and see Nature of Disclosure) and if good faith prepetition solicitation of a prepackaged plan is exempted from the antifraud provisions of the securities laws (§ 1125(e), Bankruptcy Code and see Solicitation Procedures). In contrast, there is no doubt on the applicability of these safe harbors in traditional Chapter 11 cases (see Practice Note, Chapter 11 Plan Process: Overview: Relation to Securities Laws).

- **Ongoing operational issues.** Because the time spent in a prepack bankruptcy is so short, there may only be enough time to address a limited number of operational issues under the protection of the automatic stay, such as rejecting executory contracts and leases or selling significant assets. Also, if poor management contributed to causing the debtor's bankruptcy, then the same management team that drove the company into bankruptcy is more likely to remain in place. As a result, the risk of another bankruptcy filing in the future may be higher. In contrast, in a traditional Chapter 11 case more time and opportunity exists to implement both a financial and operational restructuring, intervene into the business, and reposition the company.

- **Remaining non-financial claims.** In a prepack bankruptcy, there is often not enough time to adequately identify, track, solicit, reconcile, and resolve trade, litigation, and other non-financial claims, nor to estimate **contingent claims**. As a consequence, these claims often remain unimpaired and non-dischargable. They "ride through" the bankruptcy unaffected with their holders not entitled to vote on the plan. However, in a traditional Chapter 11 case, the process typically involves notifying all potential creditors of the debtor so that all its debts may be **discharged** on confirmation of the plan (see Practice Note, Chapter 11 Plan Process: Overview: Chapter 11 Discharge).

Disadvantages Relative to Out-of-Court Restructurings

Compared to an out-of-court restructuring, the main disadvantages of a prepack are the same as those applicable to all Chapter 11 bankruptcies which generally make Chapter 11 a last resort. They include, among others:

- **Higher cost.** Chapter 11 is usually more expensive than an out-of-court workout. Not only must the debtor pay fees for its own attorneys and other professionals (such as an investment banker, accountant, or other financial consultants), it must also bear the cost of professional fees for the creditors' committee (see Practice Note, Chapter 11 Creditors' Committees: Retain Professionals).

- **Loss of control.** Management personnel of the debtor risk being displaced by a **Chapter 11 trustee** (see Practice Note, Appointing or Electing a Chapter 11 Trustee) or by a **Chapter 7 case trustee** (see Practice Note, Duties of a Chapter 7 Bankruptcy Trustee: Appointment to a Chapter 7 Bankruptcy Case) if the court converts the case to Chapter 7. Although rare, a Chapter 11 trustee can be appointed by the court to run the business if there is fraud or gross mismanagement by the debtor's management (see Practice Notes, Appointing or Electing a Chapter 11 Trustee and Serving as a Chapter 11 Trustee).

- **Court approval.** The debtor must seek the court's approval for all decisions outside the **ordinary course of business**, such as the sale of significant assets or the rejection of material contracts.

- **Increased public scrutiny.** Because Chapter 11 is such a public and transparent process, the debtor is subject to more public scrutiny. This can be stigmatizing and may weaken the public's confidence in the company. This in turn may negatively impact customer and vendor relationships and cause difficulty in retaining employees.

- **Disclosure obligations and loss of confidentiality.** The debtor's finances become an open book on the filing of the bankruptcy petition. A complete **schedule** of assets and liabilities and a **statement of financial affairs** must be provided soon after the bankruptcy is filed (see Practice Note, Schedules and Statements of Financial Affairs:

Overview). The debtor must comply with financial reporting requirements, such as monthly operating reports, and other administrative burdens (see Practice Note, US Trustee Guidelines and Requirements for Chapter 11 Debtors).

Impact of the 2005 BAPCPA Amendments

In 2005, the BAPCPA made sweeping changes to the Bankruptcy Code that promoted the expedited resolution of bankruptcy cases generally. Some BAPCPA amendments have directly encouraged the use of prepacks and others have done so indirectly by making traditional reorganizations more difficult and expensive.

BAPCPA Provisions Facilitating Prepacks

BAPCPA amendments concerning the postpetition solicitation and **section 341 meetings** of creditors have directly facilitated prepackaged Chapter 11 cases.

Postpetition Solicitation

New section 1125(g) of the Bankruptcy Code permits a company to continue soliciting votes on a prepack after a bankruptcy filing from those classes it had approached before the filing if the solicitation complies with the securities laws. This provides a safe harbor from the Bankruptcy Code's requirement that the company or other plan proponent distribute a court-approved disclosure statement containing "adequate information" before it can solicit votes on a proposed plan postpetition (§ 1125(b), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Disclosure and Solicitation).

Under prior law, a potential debtor had to solicit and receive all votes on a prepack before it filed a bankruptcy petition. Now, adverse creditors cannot derail the prepack process by filing an involuntary bankruptcy petition against the company while it is soliciting votes on a prepack because the new law allows the company to continue soliciting votes after the bankruptcy filing without a court-approved disclosure statement. Similarly, the amendment also allows a company to file a voluntary bankruptcy petition if its situation deteriorates and complete the solicitation and voting process after the filing, resulting in the voting period "straddling" the **petition date**. This strategy is specifically contemplated in the Amended Procedural Guidelines for Prepackaged Chapter 11 Cases in the United States Bankruptcy Court for the Southern District of New York, as amended on August 1, 2013 (SDNY Prepack Guidelines) and the Procedural Guidelines for Prepackaged and Prenegotiated Chapter 11 Cases in the United States Bankruptcy Court for the Eastern District of New York (EDNY Prepack Guidelines) (see Box, Local Bankruptcy Rules: Prepacks).

Section 341 Meeting of Creditors

Previously, the US Trustee was required in every case to convene a section 341 meeting of creditors within the first 20 to 40 days after the filing of the bankruptcy petition at which creditors have the opportunity to examine the debtor under oath regarding its financial affairs. New section 341(e) of the Bankruptcy Code allows the bankruptcy court to cancel this meeting in a prepackaged Chapter 11 case, because it is unnecessary as the debtor has already negotiated with most or all

of its creditors. Under these circumstances, a section 341 meeting would only delay confirmation of the plan. This change expedites and simplifies the confirmation of prepackaged plans.

BAPCPA Provisions Deterring Traditional Chapter 11 Cases

BAPCPA amendments addressing the following issues have made traditional Chapter 11 cases more difficult and have indirectly encouraged the use of prepacks.

Exclusivity

Under amended section 1121 of the Bankruptcy Code, a court cannot extend a debtor's exclusivity period beyond 18 months after the petition date (see Practice Note, The Chapter 11 Plan Process: Overview: Who May File a Plan? and Timeline of the Chapter 11 Plan Process). As a result, many companies now must spend significantly more time preparing the case before filing for bankruptcy, which may include negotiating and formulating the plan (see Practice Note, Bankruptcy: Overview of the Chapter 11 Process: Case Preparation and Timeline of Chapter 11 Cases by Type). Under prior law, a debtor had the exclusive right during the first 120 days of the case to file a plan, with no limit to the number of extensions of exclusivity that it could obtain.

Nonresidential Real Estate Leases

Under amended section 365(d)(4) of the Bankruptcy Code, a debtor has no more than 210 days from the petition date to assume or reject nonresidential real estate leases, absent the written consent of each landlord (see Practice Note, Executory Contracts and Leases: Overview: Time Limitations and the Gap Period). Previously, a debtor could generally assume or reject nonresidential real estate leases at any time before confirmation of a plan. This amendment can result in the need for more pre-bankruptcy planning. Also, this could undermine retail debtors' reorganization efforts if they do not have a full business cycle to evaluate the performance and operations of their various locations before having to decide which leases to assume or reject (see Practice Note, Retail Industry Bankruptcies: Overview).

The Consolidated Appropriations Act, 2021 amended section 365(d)(4) to allow debtors to extend their time to assume or reject leases by an additional 90 days (for a total of up to 300 days), effective through December 27, 2022, but continuing to apply to bankruptcy cases filed before the sunset date (see Practice Note, Executory Contracts and Leases: Overview: Consolidated Appropriations Act, 2021).

Reclamation Rights

Under prior law, sellers who, in the ordinary course of business, shipped **goods** received by the debtor while **insolvent** within ten days before the filing of the bankruptcy petition could reclaim those goods if the seller made a written demand for **reclamation** within ten days after the debtor's receipt of the goods or within 20 days of that receipt if the original ten-day period expired after the filing of the bankruptcy case. Alternatively, the debtor could ask the court to grant the seller an

administrative expense claim for the value of the goods instead of their return. Administrative expense claims must be paid in full in cash, but are not payable until the **effective date** of the plan (§ 1129(a)(9)(A), Bankruptcy Code).

However, under amended section 546(c) of the Bankruptcy Code, the reclamation period is extended to goods received within 45 days before the bankruptcy filing. Although unclear, it also appears that an administrative expense claim may no longer be substituted for the seller's right to the prompt return of its goods or payment in full. Therefore, if a settlement is not negotiated with the seller, reclamation rights can diminish the value of a lender's inventory collateral, and these negotiations are likely to place a further drain on the debtor's time and cash resources.

For more information on reclamation, see:

- Practice Note, Reclamation Rights in Bankruptcy.
- Timelines of the Reclamation Process under BAPCPA and Pre-BAPCPA.
- Standard Document, Bankruptcy Reclamation Demand Letter.
- Standard Document, Bankruptcy Reclamation Complaint.

20-Day Goods

Closely related to the point above, if a seller fails to make a timely reclamation claim, under the BAPCPA amendments it may assert an administrative expense claim for the value of goods sold in the ordinary course of business and received by the debtor within 20 days before a bankruptcy filing (§§ 503(b)(9), 546(c)(2), Bankruptcy Code). This applies regardless of whether the debtor still has the goods or was insolvent when it received them. As a result, in many cases a substantial amount of a debtor's trade claims can be converted from **general unsecured claims** receiving partial payment to claims entitled to full payment under a plan. Some commentators believe that substantial section 503(b)(9) claims have caused several debtors to **liquidate**.

For more information on section 503(b)(9) claims, see Practice Note, Reclamation Rights in Bankruptcy: Section 503(b)(9) Claim as Alternative Remedy and Standard Document, Request for Allowance and Payment of Section 503(b)(9) Administrative Claim.

Utilities

Previously, a utility could discontinue service to a debtor only if it did not receive "adequate assurance of payment" within 20 days of the bankruptcy filing. This assurance could consist of items other than cash, such as an administrative expense claim or a history of timely pre-bankruptcy payments. However, under amended section 366(c) of the Bankruptcy Code, debtors may have to use cash for **security deposits**, **letters of credit**, surety bonds, or other security. Courts are explicitly prohibited from considering a debtor's payment history or allowing an administrative expense claim to constitute adequate assurance of payment. This change represents another drain on a debtor's cash resources.

Employee Priority Claims

Under prior law, employees received **priority claims** for wages, salaries, and **commissions**, including vacation, **severance**, and sick pay, earned within 90 days before the earlier of the bankruptcy filing or the cessation of the debtor's business, and claims for contributions to an **employee benefit plan** for services rendered within 180 days of that date. These claims were subject to an aggregate cap of $4,925 per employee. However, under amended sections 507(a)(4) and (a)(5) of the Bankruptcy Code, employee priority claims can accrue up to 180 days before bankruptcy and the aggregate cap has been increased to $15,150 per employee (subject to cost of living adjustments). This is another change making traditional Chapter 11 more expensive for debtors.

The Prepack Process

Following the negotiation of a plan between the debtor and its major creditors, and assuming a full prepack is used, a prepack can generally be thought of as a two-phase process. The prepack process consists of the:

- Prepetition phase, including disclosure to creditors about the proposed prepackaged plan and the solicitation of their votes (see Prepetition: Disclosure and Solicitation).
- Postpetition phase, including the bankruptcy court's approval of the plan and the disclosure statement used in the prepetition solicitation (see Postpetition: The Chapter 11 Case).

In the prepetition phase, the debtor must also engage in many of the same case preparation activities as if it were preparing a traditional Chapter 11 case (see Practice Note, Bankruptcy: Overview of the Chapter 11 Process: Case Preparation). However, many of the activities that typically occur within the first few days and weeks after the filing of a traditional Chapter 11 case are eliminated, with the exception of negotiating with prepetition lenders and DIP lenders (which occurs prepetition in a prepack) and the filing of statements and schedules (which are usually filed with the bankruptcy petition in a prepack) (see Practice Note, Bankruptcy: Overview of the Chapter 11 Process: First Days and Weeks).

The postpetition phase could also involve many of the same procedural and substantive matters that are typically dealt with in the case administration stage of a traditional Chapter 11 case, depending on the extent to which issues with any constituencies remain unresolved or unexpected issues arise (see Practice Note, Bankruptcy: Overview of the Chapter 11 Process: Case Administration). Procedurally, these could include retaining counsel and other professionals. Substantively, these could include responding to motions to compel the debtor to assume or reject executory contracts or for relief from the automatic stay.

For a typical timeline of the prepack process, see Timeline of a Prepackaged Bankruptcy Case.

Prepetition: Disclosure and Solicitation

In a full prepack, the debtor does not file its bankruptcy petition until it has received enough votes to confirm the prepackaged plan (at least two-thirds in dollar amount and more than one-half in number of claims actually voting in each class (§ 1126(c), Bankruptcy Code)). This involves:

- Providing disclosure about the proposed plan to those voting on the plan (see Nature of Disclosure).
- Soliciting votes on the proposed plan (see Solicitation Procedures).

Nature of Disclosure

The Bankruptcy Code provides that a prepetition solicitation is proper only if it complies with "any applicable nonbankruptcy law, rule, or regulation governing the adequacy of disclosure in connection with such solicitation" (§ 1126(b)(1), Bankruptcy Code). In the absence of any applicable nonbankruptcy law (for example, because the plan does not involve an offer to publicly buy or sell securities), the solicitation must comply with the "adequate information" standard generally applicable to disclosure statements in traditional Chapter 11 cases (§ 1126(b)(2), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Adequacy of Disclosure). The purpose is to prevent parties from evading the Bankruptcy Code's disclosure and solicitation requirements by soliciting votes prepetition.

No particular body of nonbankruptcy law governs the adequacy of disclosure in a prepack. However, if the plan contemplates the public issuance of debt or equity securities, the debtor must comply with the federal and state securities laws before soliciting votes on the plan. For example, a plan may be subject to the:

- Registration requirements under the Securities Act, if the plan involves an offer to exchange outstanding securities for new securities (see Practice Note, Registration Statement: Form S-4 and Debt Exchange Offers).
- **Proxy** solicitation rules under Section 14 of the **Securities Exchange Act of 1934, as amended** (15 U.S.C. § 78n) (Exchange Act), if the plan seeks to exchange securities registered under Section 12 of the Exchange Act (15 U.S.C. § 78*l*) (see Practice Note, Proxy Statements).
- Additional disclosure requirements involved in a **going private transaction** (see Practice Note, Going Private Transactions: Overview: Disclosure Obligations in a Going Private Transaction).
- Antifraud provisions of the Securities Act and the Exchange Act (see Practice Note, Liability Provisions: Securities Offerings).
- State corporate and **blue sky laws** (see Practice Note, US Securities Laws: Overview: State Securities Regulation).

If the debtor can offer securities under one of the following exemptions concerning solicitation of the prepackaged plan, it will not have to file a Securities Act **registration statement**:

- An exemption under:

- Section 3 of the Securities Act (15 U.S.C. § 77c), which exempts certain securities and transactions from registration (see Section 3 Registration Exemptions: Chart); or

- **Section 4(a)(2)** of the Securities Act (15 U.S.C. § 77d(a)(2)), which exempts from registration offers and sales of securities by the issuer that do not involve a public offering or distribution (see Section 4 Registration Exemptions: Chart and Practice Note, Out-of-Court Restructurings: Overview: Section 4(a)(2) Exemption).

However, these exemptions are of little use unless the company or its securities fit within Section 3's limited exceptions or its securities are held by a relatively small number of **sophisticated investors**.

- The exemption under Section 3(a)(9) of the Securities Act (15 U.S.C. § 77c(a)(9)), which exempts from registration the conversion of debt into equity securities of the same issuer if no consideration is payable (see Practice Note, Out-of-Court Restructurings: Overview: Section 3(a)(9) Exemption). However, this exemption is of limited use if the debtor's securities are widely disbursed and it cannot complete the solicitation without the services of an **investment bank**.

- The exemption from registration under section 1145 of the Bankruptcy Code which, subject to certain exceptions, exempts the offer and sale of securities under a plan in exchange for a claim against the debtor (see Practice Note, Rights Offerings in Bankruptcy: Section 1145 Exemption). However, it is unclear whether this exemption applies to securities issued concerning the prepetition solicitation of a prepackaged plan. The **Securities and Exchange Commission's** (SEC) informal view is that the Bankruptcy Code's exemption does not apply to prepackaged plans, which it believes are subject to the Securities Act unless they qualify for another exemption.

Unless the prepack qualifies for an exemption, a prepack's solicitation materials should comply with both the adequate information standard of the Bankruptcy Code and any disclosure standards in applicable nonbankruptcy law. These materials should comply with the Bankruptcy Code's adequate information standard because it is unclear whether compliance with securities law disclosure standards can substitute for compliance with the adequate information standard. The Bankruptcy Code does not explicitly state that compliance with nonbankruptcy disclosure law automatically validates prepetition votes, only that these votes are deemed valid if the solicitation complied with those laws (§ 1126(b)(1), Bankruptcy Code). Conversely, compliance with the Bankruptcy Code's disclosure standards does not protect the debtor from liability under the securities laws.

Therefore, a debtor should ensure it complies with applicable securities laws and not rely on an exemption from registration unless it is certain the prepack qualifies. This eliminates the risk of liability under the Securities Act and that the SEC or a bankruptcy court will later determine that the offering should have been registered, resulting in the debtor having to repeat the process and causing added delay and expense.

Solicitation Procedures

At a disclosure statement hearing, the bankruptcy court must consider the procedures used in soliciting votes on the plan (Fed. R. Bankr. P. 3017(e)). Like the issue of disclosure, solicitation procedures used in prepacks are governed by applicable nonbankruptcy law (securities laws), in addition to the requirements of the Bankruptcy Code. The Federal Rules of Bankruptcy Procedure (Bankruptcy Rules) deem votes valid that have been solicited prepetition if certain procedural requirements are satisfied (Fed. R. Bankr. P. 3018(b)). These procedural requirements address the following issues:

- **Who should be solicited.** Although the Bankruptcy Rules literally require that votes obtained prepetition be solicited from the **record holder** of securities (Fed. R. Bankr. P. 3018(b)), many courts have adopted a ruling from case law requiring votes to be solicited only from **beneficial owners** (or their authorized agents whose authority is established under bankruptcy law) (see *In re Southland Corp.*, 124 B.R. 211, 227 (Bankr. N.D. Tex. 1991)). However, because of confidentiality concerns, in practice a "master ballot" procedure is often used in which the record holder:
    - tabulates each beneficial holder's vote on the plan; and
    - completes a master ballot reporting beneficial owner votes by customer account number and principal amount.

  In this way, it is possible to determine if the plan receives the required number and amount of votes, while preserving confidentiality (see Practice Note, Chapter 11 Plan Process: Overview: Required Votes).

- **Transmission of solicitation materials.** The plan must be distributed to "substantially all" members of every voting class that the debtor solicits prepetition or the court will invalidate any votes actually received from members of that class (Fed. R. Bankr. P. 3018(b)).

- **Solicitation period.** In addition to complying with any securities laws requirements regarding the time permitted to respond to the solicitation, the debtor must ensure that this period is not "unreasonably short" under bankruptcy law standards (Fed. R. Bankr. P. 3018(b)). The Bankruptcy Code and the Bankruptcy Rules do not set out any specific minimum periods for obtaining votes on a plan. Compliance with the securities laws (such as the **tender offer** rules, which in practice debtors often look to for guidance) may not be sufficient under bankruptcy law (see *In re Southland*, 124 B.R. at 227). Some commentators have suggested that 28 days is an appropriate amount of time, as this is the amount of time given to consider a disclosure statement (Fed. R. Bankr. P. 2002(b)). However, the SDNY Prepack Guidelines and the EDNY Prepack Guidelines presume that a period ranging from 14 to 21 days is reasonable, depending on whether or not the security is publicly traded (see Box, Local Bankruptcy Rules: Prepacks).

There is a limited safe harbor in the Bankruptcy Code from liability under the antifraud provisions of the federal and state securities laws for the offer, issuance, sale, or purchase of securities offered or sold under a plan, if the plan proponent solicited acceptances in good faith and complied with the requirements of the Bankruptcy Code (§ 1125(e), Bankruptcy Code). It is unclear whether this safe harbor is available for prepetition solicitations of votes on prepackaged plans. As a result, it is good practice to include in the confirmation order approving the plan a specific finding of the court that the solicitation was in good faith and in compliance with section 1125(e) of the Bankruptcy Code. This should protect those parties involved in the prepetition solicitation from federal and state liability.

Postpetition: The Chapter 11 Case

If the plan receives the necessary votes required by the Bankruptcy Code within the solicitation period, the debtor can file its proposed prepackaged plan, disclosure statement, and ballots together with its bankruptcy petition. If the debtor's situation

suddenly deteriorates and it must file for bankruptcy protection before it can complete the solicitation process, then it may file a partial prepack (see Prepack Techniques) and continue soliciting votes postpetition (§ 1125(g), Bankruptcy Code and see BAPCPA Provisions Facilitating Prepacks).

The postpetition phase is condensed and typically involves only the following key hearings:

- **"First day" hearing.** Like in a traditional Chapter 11 case, this hearing focuses on the approval of DIP financing, retention of counsel, and other procedural motions. However, it may also include requests for relief that are only typical in prepackaged cases, such as approval to pay trade creditors or unimpaired general unsecured creditors in the ordinary course of business (on the assumption that creditors voting in a prepack have already approved a plan providing for those claims to be unimpaired).

- **Confirmation hearing.** Debtors typically request a joint hearing to approve the adequacy of the disclosure statement and confirmation of the plan. By collapsing what is normally a two-step process in a traditional Chapter 11 case into a one-step process in a prepack, the process is shortened by at least 28 days. This 28-day notice period applies to both filing objections to the disclosure statement and to confirmation of the plan, and if the hearings are combined, only one 28-day notice must be given rather than two (Fed. R. Bankr. P. 2002(b)). Also, the debtor may obtain an expedited hearing, depending on the circumstances (Fed. R. Bankr. P. 9006(c)). At least one court has held that the Bankruptcy Rules do not require 28 days' notice **after** the petition date; instead under appropriate circumstances the notice period can start prepetition (see *In re Roust Corp.*, No. 16-23786 (Bankr. S.D.N.Y. Jan. 6, 2017)).

To further streamline the postpetition phase, the debtor may eliminate the **bar date** for filing **proofs of claim**, shortening the process by at least another 21 days, the required notice period to fix a bar date (Fed. R. Bankr. P. 2002(a)(7)). This is possible because non-financial claims (such as securities fraud and mass tort claims) typically "ride through" a prepackaged bankruptcy unaffected by the proceedings. Because their rights are unaltered, they are deemed unimpaired (§ 1124(1), Bankruptcy Code and see Practice Note, Reinstatement of Prepetition Loans in Bankruptcy: What is Impairment?). These claim holders are not subject to a bar date because their right to payment is not affected by the bankruptcy (meaning they do not need to file a proof of claim to preserve their rights and their claims are not discharged on confirmation of the plan). Holders of unimpaired claims riding through a prepackaged bankruptcy are also not entitled to vote and are deemed to have accepted the plan (§ 1126(f), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Who Can Vote on a Plan?).

Creditors' committees are typically not appointed in prepackaged cases if the plan proposes to leave unsecured creditors unimpaired. When these committees are appointed, they are usually composed of members of a committee representing holders of public securities organized before the filing of the case. Further, **equity committees** are not appointed in cases where **equity security holders** are clearly **out of the money**.

Disclosure Statement Approval

If the plan involves the public issuance of securities, the disclosure statement must comply with the applicable securities laws (§ 1126(b)(1), Bankruptcy Code and see Nature of Disclosure). Usually this also suffices for bankruptcy purposes, as generally bankruptcy courts' disclosure standards are less onerous than the requirements of the securities laws. However, sometimes they may be similar or more rigorous, depending on the circumstances, so debtors cannot assume that complying

with the securities laws is sufficient. Therefore, the disclosure statement should also independently satisfy the adequate information standard of the Bankruptcy Code, as if the prepack were a traditional Chapter 11 case (§ 1125(a), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Adequacy of Disclosure). For example, in every case the court must ensure that the "best interests of creditors test" is satisfied to confirm a plan (§ 1129(a)(7)(A), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: "Best Interests of Creditors Test"). Often, this requires that the disclosure statement include a liquidation analysis showing what the claim holder would receive if the debtor were liquidated under Chapter 7, which is information that may not be required under the securities laws (see Practice Note, Debtor's Liquidation Analysis: Best Interests of Creditors Test).

If there is no applicable nonbankruptcy law (for example, because the plan does not involve an offer to buy or sell public securities), the court must only determine whether the disclosure statement complies with the adequate information standard of the Bankruptcy Code (§§ 1125(a), 1126(b)(2), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Adequacy of Disclosure).

Plan Approval

To be confirmed, a prepackaged plan must satisfy the same statutory confirmation requirements as a traditional Chapter 11 plan (§ 1129(a), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Confirmation of a Plan: Consensual Plans). This includes the requirement that creditors holding at least two-thirds in dollar amount and more than one-half in number of claims actually voting in each class vote to approve the plan (§ 1126(c), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Required Votes).

However, if the plan is accepted by at least one but not all **impaired** classes, it may be confirmed using the cramdown provisions of the Bankruptcy Code (§ 1129(b)(1), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Confirmation of a Plan: Cramdown Plans). In practice this is rare due to the consensual nature of prepacks and because prepacks are often arranged so that unsecured creditors are unimpaired and therefore deemed to have accepted the plan (see Practice Note, Chapter 11 Plan Process: Overview: Unimpaired Claims or Interests).

Potential Challenges to Prepacks

While prepackaged plans may be challenged on the same grounds as traditional Chapter 11 plans (for example, objections related to the proper classification of claims (see Practice Note, Chapter 11 Plan Process: Overview: Classification and Treatment of Claims and Interests)), they are more vulnerable to challenge in several areas, including:

- Disclosure and solicitation (see Disclosure and Solicitation).
- **Feasibility** (see Feasibility).
- Payment of prepetition trade debt (see Payment of Prepetition Trade Debt).

Disclosure and Solicitation

Challenges to the debtor's solicitation procedures and the adequacy of its prepetition disclosure are often the most successful objections to prepacks (see Prepetition: Disclosure and Solicitation). After the Chapter 11 case is filed, the bankruptcy court may invalidate any prepetition votes it determines were improperly solicited and not count them towards the acceptances required to confirm the plan (§ 1126(b), Bankruptcy Code and Fed. R. Bankr. P. 3018(b)). In this case, the debtor would need to resolicit acceptances and repeat the entire process, subject to the disclosure and solicitation standards of the Bankruptcy Code. Generally, these standards require the bankruptcy court to determine in advance that the disclosure statement to be used in the solicitation contains adequate information (§ 1125(b), Bankruptcy Code and see Practice Note, Chapter 11 Plan Process: Overview: Disclosure and Solicitation). These extra steps may add expense, delay, and uncertainty to the process, which undermines the fundamental purposes of the prepack.

The two aspects of the solicitation process most vulnerable to challenge are:

- The nature of the disclosure about the proposed plan made by the debtor to those parties from whom it solicits votes (see Nature of Disclosure).
- The procedures used by the debtor to solicit votes (see Solicitation Procedures).

While the Bankruptcy Code explicitly addresses these issues for traditional Chapter 11 cases, it does not do the same for prepacks. Unlike in traditional Chapter 11 cases, in prepacks the bankruptcy court does not determine in advance the adequacy of the disclosure statement nor fix the time within which creditors may accept or reject the plan after the company begins soliciting their votes. This retroactive approval of the disclosure statement and the solicitation procedures is one of the biggest sources of risk and uncertainty in a prepack (see Disadvantages Relative to Traditional Chapter 11 Cases).

Feasibility

Prepacks are particularly susceptible to challenges based on the feasibility requirement that confirmation of the plan is not likely to later result in liquidation or the need for further financial reorganization of the debtor, unless the plan proposes or contemplates liquidation or further reorganization (§ 1129(a)(11), Bankruptcy Code and Practice Note, Feasibility Standard: Confirmation of a Plan Under Section 1129(a)(11)). Feasibility is a common issue because prepacks typically deal with only the major bond and secured debt of the debtor, treating contingent, **unliquidated**, and disputed claims as unimpaired to ride through the bankruptcy. Holders of these claims that seek to have their claims estimated or determined can challenge the assumption that the debtor will have sufficient assets to pay them when due, which if not true may result in a liquidation or further reorganization.

Payment of Prepetition Trade Debt

It is common practice in prepacks for debtors to obtain bankruptcy court approval for the uninterrupted payment of prepetition trade debt because this is typically necessary for the prepack to succeed. However, the legal basis for allowing a debtor to pay prepetition claims while it is in bankruptcy, even with the approval of the bankruptcy court, is not entirely clear.

Courts typically use their broad equitable powers under section 105 of the Bankruptcy Code to justify this practice, likely because they assume these payments are contemplated by the prepackaged plan that has already been accepted by all impaired classes. If adverse creditors can challenge this assumption, the company's suppliers may then react negatively to the prepack. For example, they may derail the prepack during the solicitation period by refusing to deal with the company or extend credit, which could threaten liquidity and potentially force it to file a traditional Chapter 11 bankruptcy case.

Local Bankruptcy Rules: Prepacks

The following Chart contains links to summaries of the local rules for prepacks in certain jurisdictions, allowing attorneys to compare rules across different bankruptcy courts.

Alabama	
• Middle District of Alabama	Practice Note, Local Bankruptcy Rules: Alabama (M.D. Ala.): Prepacks: Local Rules.
• Northern District of Alabama	Practice Note, Local Bankruptcy Rules: Alabama (N.D. Ala.): Prepacks: Local Rules.
• Southern District of Alabama	Practice Note, Local Bankruptcy Rules: Alabama (S.D. Ala.): Prepacks: Local Rules.
Arizona	Practice Note, Local Bankruptcy Rules: Arizona: Prepacks: Local Rules.
Arkansas	Practice Note, Local Bankruptcy Rules: Arkansas (E.D./W.D. Ark.): Prepacks: Local Rules.
California	
• Central District of California	Practice Note, Local Bankruptcy Rules: California (C.D. Cal.): Prepacks: Local Rules.
• Eastern District of California	Practice Note, Local Bankruptcy Rules: California (E.D. Cal.): Prepacks: Local Rules.
• Northern District of California	Practice Note, Local Bankruptcy Rules: California (N.D. Cal.): Prepacks: Local Rules.
• Southern District of California	Practice Note, Local Bankruptcy Rules: California (S.D. Cal.): Prepacks: Local Rules.

Colorado	Practice Note, Local Bankruptcy Rules: Colorado: Prepacks: Local Rules.
Connecticut	Practice Note, Local Bankruptcy Rules: Connecticut: Prepacks: Local Rules.
Delaware	Practice Note, Local Bankruptcy Rules: Delaware: Prepacks: Local Rules.
Florida	
• Middle District of Florida	Practice Note, Local Bankruptcy Rules: Florida (M.D. Fla.): Prepacks: Local Rules.
• Northern District of Florida	Practice Note, Local Bankruptcy Rules: Florida (N.D. Fla.): Prepacks: Local Rules.
• Southern District of Florida	Practice Note, Local Bankruptcy Rules: Florida (S.D. Fla.): Prepacks: Local Rules.
Georgia	
• Middle District of Georgia	Practice Note, Local Bankruptcy Rules: Georgia (M.D. Ga.): Prepacks: Local Rules.
• Northern District of Georgia	Practice Note, Local Bankruptcy Rules: Georgia (N.D. Ga.): Prepacks: Local Rules.
• Southern District of Georgia	Practice Note, Local Bankruptcy Rules: Georgia (S.D. Ga.): Prepacks: Local Rules.
Illinois	
• Central District of Illinois	Practice Note, Local Bankruptcy Rules: Illinois (C.D. Ill.): Prepacks: Local Rules.
• Northern District of Illinois	Practice Note, Local Bankruptcy Rules: Illinois (N.D. Ill.): Prepacks: Local Rules.
• Southern District of Illinois	Practice Note, Local Bankruptcy Rules: Illinois (S.D. Ill.): Prepacks: Local Rules.
Iowa	

• Northern District of Iowa	Practice Note, Local Bankruptcy Rules: Iowa (N.D. Iowa): Prepacks: Local Rules.
• Southern District of Iowa	Practice Note, Local Bankruptcy Rules: Iowa (S.D. Iowa): Prepacks: Local Rules.
Kansas	Practice Note, Local Bankruptcy Rules: Kansas: Prepacks: Local Rules.
Louisiana	
• Eastern District of Louisiana	• Practice Note, Local Bankruptcy Rules: Louisiana (E.D. La.): Prepacks: Local Rules.
• Western District of Louisiana	• Practice Note, Local Bankruptcy Rules: Louisiana (W.D. La.): Prepacks: Local Rules.
Maine	Practice Note, Local Bankruptcy Rules: Maine: Prepacks: Local Rules.
Maryland	Practice Note, Local Bankruptcy Rules: Maryland: Prepacks: Local Rules.
Massachusetts	Practice Note, Local Bankruptcy Rules: Massachusetts: Prepacks: Local Rules.
Michigan	
• Eastern District of Michigan	Practice Note, Local Bankruptcy Rules: Michigan (E.D. Mich.): Prepacks: Local Rules.
• Western District of Michigan	Practice Note, Local Bankruptcy Rules: Michigan (W.D. Mich.): Prepacks: Local Rules.
Minnesota	Practice Note, Local Bankruptcy Rules: Minnesota: Prepacks: Local Rules.
Mississippi	Practice Note, Local Bankruptcy Rules: Mississippi (N.D./S.D. Miss.): Prepacks: Local Rules.
Missouri	

• Eastern District of Missouri	Practice Note, Local Bankruptcy Rules: Missouri (E.D. Mo.): Prepacks: Local Rules.
• Western District of Missouri	Practice Note, Local Bankruptcy Rules: Missouri (W.D. Mo.): Prepacks: Local Rules.
Nevada	Practice Note, Local Bankruptcy Rules: Nevada: Prepacks: Local Rules.
New Hampshire	Practice Note, Local Bankruptcy Rules: New Hampshire: Prepacks: Local Rules.
New Jersey	Practice Note, Local Bankruptcy Rules: New Jersey: Prepacks: Local Rules.
New York	
• Eastern District of New York	Practice Note, Local Bankruptcy Rules: New York (EDNY): Prepacks: Local Rules.
• Southern District of New York	Practice Note, Local Bankruptcy Rules: New York (SDNY): Prepacks: Local Rules.
North Carolina	
• Eastern District of North Carolina	Practice Note, Local Bankruptcy Rules: North Carolina (E.D.N.C.): Prepacks: Local Rules.
• Middle District of North Carolina	Practice Note, Local Bankruptcy Rules: North Carolina (M.D.N.C.): Prepacks: Local Rules.
• Western District of North Carolina	Practice Note, Local Bankruptcy Rules: North Carolina (W.D.N.C.): Prepacks: Local Rules.
Ohio	
• Northern District of Ohio	Practice Note, Local Bankruptcy Rules: Ohio (N.D. Ohio): Prepacks: Local Rules.
• Southern District of Ohio	Practice Note, Local Bankruptcy Rules: Ohio (S.D. Ohio): Prepacks: Local Rules.
Oregon	Practice Note, Local Bankruptcy Rules: Oregon: Prepacks: Local Rules.

Pennsylvania	
• Eastern District of Pennsylvania	Practice Note, Local Bankruptcy Rules: Pennsylvania (E.D. Pa.): Prepacks: Local Rules.
• Middle District of Pennsylvania	Practice Note, Local Bankruptcy Rules: Pennsylvania (M.D. Pa.): Prepacks: Local Rules.
• Western District of Pennsylvania	Practice Note, Local Bankruptcy Rules: Pennsylvania (W.D. Pa.): Prepacks: Local Rules.
Rhode Island	Practice Note, Local Bankruptcy Rules: Rhode Island: Prepacks: Local Rules.
South Carolina	Practice Note, Local Bankruptcy Rules: South Carolina: Prepacks: Local Rules.
Tennessee	
• Eastern District of Tennessee	Practice Note, Local Bankruptcy Rules: Tennessee (E.D. Tenn.): Prepacks: Local Rules.
• Middle District of Tennessee	Practice Note, Local Bankruptcy Rules: Tennessee (M.D. Tenn.): Prepacks: Local Rules.
• Western District of Tennessee	Practice Note, Local Bankruptcy Rules: Tennessee (W.D. Tenn.): Prepacks: Local Rules.
Texas	
• Eastern District of Texas	Practice Note, Local Bankruptcy Rules: Texas (E.D. Tex.): Prepacks: Local Rules.
• Northern District of Texas	Practice Note, Local Bankruptcy Rules: Texas (N.D. Tex.): Prepacks: Local Rules.
• Southern District of Texas	Practice Note, Local Bankruptcy Rules: Texas (S.D. Tex.): Prepacks: Local Rules.
• Western District of Texas	Practice Note, Local Bankruptcy Rules: Texas (W.D. Tex.): Prepacks: Local Rules.
Vermont	Practice Note, Local Bankruptcy Rules: Vermont: Prepacks: Local Rules.

Virginia	
• Eastern District of Virginia	Practice Note, Local Bankruptcy Rules: Virginia (E.D. Va.): Prepacks: Local Rules.
• Western District of Virginia	Practice Note, Local Bankruptcy Rules: Virginia (W.D. Va.): Prepacks: Local Rules.
Washington	
• Eastern District of Washington	Practice Note, Local Bankruptcy Rules: Washington (E.D. Wash.): Prepacks: Local Rules.
• Western District of Washington	Practice Note, Local Bankruptcy Rules: Washington (W.D. Wash.): Prepacks: Local Rules.
West Virginia	
• Northern District of West Virginia	Practice Note, Local Bankruptcy Rules: West Virginia (N.D. W. Va.): Prepacks: Local Rules.
• Southern District of West Virginia	Practice Note, Local Bankruptcy Rules: West Virginia (S.D. W. Va.): Prepacks: Local Rules.
Wisconsin	
• Eastern District of Wisconsin	Practice Note, Local Bankruptcy Rules: Wisconsin (E.D. Wis.): Prepacks: Local Rules.
• Western District of Wisconsin	Practice Note, Local Bankruptcy Rules: Wisconsin (W.D. Wis.): Prepacks: Local Rules.

Other Pre-Bankruptcy Tactics

Another technique commonly used to address problems at an early stage and facilitate restructurings is the pre-arranged (or pre-negotiated) reorganization, in which the debtor negotiates the key terms of a plan with its most significant creditors but does not solicit any votes until after it files its bankruptcy petition and the court has approved a disclosure statement (see Practice Note, Bankruptcy: Overview of the Chapter 11 Process: Pre-Arranged (or Pre-Negotiated)). Also, pre-arranged **section 363 sales** may be negotiated before the debtor has filed for bankruptcy. For example, Chrysler, General Motors, and Lehman Brothers each prearranged section 363 sales of substantial portions of their operating assets with the help of the US government.

For information comparing prepacks with pre-arranged bankruptcies, see Practice Note, Comparison: Prepackaged v. Pre-Arranged Bankruptcy.

