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# The Importance Of Examining Reasons For Restructuring

Law360, New York (October 09, 2013, 4:06 PM ET) -- In order to understand which legal entities in a corporate family to include in a restructuring, it is critical to understand the events causing the company to be in distress. There are four general reasons why a company will consider seeking protection under Chapter 11 of the Bankruptcy Code:

(1) If a company is facing or will face a serious liquidity issue, such as the inability to refinance debt or make an upcoming debt service or amortization payment, a bankruptcy proceeding will create “breathing space” for the company to conserve cash and consider its options.

The most significant creditor groups affected by this type of a restructuring will be funded debt (i.e., bank debt and bonds) and equity. Operational debts may be affected but do not necessarily need to be. A restructuring that primarily addresses liquidity, debt service and payment issues can generally be called a “balance sheet” or “capital structure” restructuring.

A prepackaged or prenegotiated restructuring typically is best used for a balance sheet restructuring since it primarily deals with funded debt and equity.

(2) Some companies use the Chapter 11 process to implement a strategic restructuring of the business through the application of the statutory provisions of Chapter 11 of the Bankruptcy Code. For example, Chapter 11 allows for the rejection of leases and executory contracts and sets forth extensive procedures regarding the renegotiation and termination of collective bargaining agreements.

Through the use of Chapter 11, a company generally can reject above-market executory contracts to relieve itself of costly ongoing obligations. Unsecured creditors will be one of the primary groups of creditors affected in this type of restructuring.

A restructuring that primarily focuses on restructuring the operations of a company can generally be called an “operational” restructuring. Because of the prevalence of unsecured creditors in an operational restructuring, such a restructuring typically is not implemented through a prepackaged plan but may be implemented through a prenegotiated plan.

(3) If a company is facing serious going-concern or stand-alone operational issues, it may use Chapter 11 as a means to sell all or a portion of its assets free and clear of liabilities or as a means to implement a business combination. A restructuring of this type can be referred to as a “transactional” restructuring. Many transactional restructurings are implemented through a Section 363 sale process.

(4) Chapter 11 can provide a safe haven to a company that has faced or will face a catastrophic event, such as a mass tort, fraud, serious environmental problem or a

significant and sudden liquidity crisis. This type of Chapter 11 case allows the company to attain immediate protection from its creditors while it confronts the catastrophic issue. By their very nature, catastrophic filings do not permit for the pre-filing time required for the prepackaged or prenegotiated process.

To determine which legal entities of an enterprise should be included in a restructuring, the company must undergo an analysis of its debts and contractual obligations on a legal entity-by-legal entity basis. The company and its advisors must review all debt documents and consider which debts, including guarantees and pledges, will require restructuring or be affected by the impetus for or the actual restructuring.

All entities that are parties to such documents should be considered for inclusion. All contracts of affiliates of these financing entities should be reviewed to determine the impact, if any, that a restructuring of the financing entities will have on the affiliates. In addition, any affiliated entity that relies on or pools cash with the financing entities may need to be restructured as well because the restructuring may adversely impact its ability to access cash.

By way of example, if a subsidiary finance company has an upcoming coupon payment due on a note, which it will not be able to make, the subsidiary finance company should be part of the restructuring. If the holding company of the subsidiary finance company guaranteed payment on the bond, typically it should be included in the restructuring. If it is not included, the noteholders are permitted to seek to collect the amounts due from the holding company.

Thereafter, if an operating affiliate has a lease under which it is an event of default if the holding company files for bankruptcy protection, inclusion of such operating affiliate in the restructuring should be considered. Finally, if a separate affiliate pools cash with the other entities that will file for bankruptcy or relies on those entities for its financing, consideration should be given to including that entity in the restructuring.

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