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ROUNDTABLE

US BANKRUPTCY

Insolvency advisers are still waiting for the next downturn to grip the market. Liquidity levels continue to buoy corporates that might have met distress were it not for easy access to capital. Eventually, the lending trend will peak and reverse, and companies will be faced with a host of fresh challenges – many of them made even more complex by the financing habits that have developed in the last few years. Attempts to balance creditor disputes while repairing operational faults will put huge pressure on future restructuring efforts.

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Sprayregen: How would you describe the US Bankruptcy market over the last 12-18 months?

Flaschen: While there have been a few interesting Chapter 11 filings over the past 18 months, the US bankruptcy market overall has been dead compared to several years ago. We are spending much more time on out-of-court restructurings, where refinancings and consent solicitations have become much more common due to market liquidity.

Allison: The marketplace for US bankruptcy cases has been substantially impacted by excessive liquidity in the increasing values paid by buyers. These impacts include more 363 sales and plans sponsored by private equity and hedge funds. There were a number of mega cases that filed shortly before the new code came into effect in October of 2005, including Delta, Delphi, and Northwest Airlines. Most of those cases have wound their way through the system and have either confirmed a plan or are well on their way to confirming a plan. By contrast, the cases filed in 2006 were much smaller with the average debt for the top five cases slightly less than a billion in total capital. The bankruptcy market has reached the bottom of the trough.

Curchack: The last year has been a period of lowered expectations. People have stopped predicting (or stopped listening to those who predict) when the next economic downturn would lead to the next upturn in bankruptcy activity. But there has been a marked increase in two areas: litigation over issues that traditionally would have been resolved through negotiation, and the attention being paid to drafting documents in anticipation of the potential ('likely' may be a better word) restructurings that will inevitably follow the current, ever-more leveraged, M&A activity.

Brown: The bankruptcy market has been creeping forward in the last 6-9 months. National statistics reveal that the number of commercial bankruptcy filings to date in 2007 are down from 2006, which had fewer than 2005. However, the number of middle market cases being filed has increased. Chapter 7 cases are increasing in number. Capacity utilisation in larger law firms is increasing, while the mid-sized and smaller firms appear to continue to have excess capacity. Further, there is a perception among practitioners that opportunities for new matters are concentrated among a few law firms. In recent months, firms have publicised their intent to staff up for the impending wave of insolvency-related matters.

Hammer: The US bankruptcy market has been more active in the last 12 months than the statistics otherwise reveal. While it is true that business bankruptcy filings in 2006 were at their lowest levels since 1980, totalling less than 20,000, business filings actually increased throughout 2006 at a measured pace. This gradual upswing in bankruptcies has been fuelled by spectacular implosions in the subprime mortgage industry, continued restructurings of Tier 1 and 2 automotive suppliers, weakness in the housing market, and the tail end of the airline bankruptcies.

Sprayregen: In your opinion, what point have we reached in the current 'restructuring cycle'? What has been the impact of the liquidity in the capital markets and the availability of rescue financing?

Allison: I believe we are at the bottom of the cycle. The projection of when the curve will uptick is uncertain. The economy has been buoyant through $3 gasoline soon reaching $4, a downturn in the US automotive industry, and a dramatic slowdown in the US housing industry. Examining the record breaking performance of US and global equity markets as a leading indicator, it is clear a significant improvement in the restructuring sector may still be 12-18 months away. Shrinking risk premiums for rescue debt has made LBO and exit facilities cheaper and, therefore, underperforming companies easier to acquire.

Stegenga: The uptick in interest rates since 2003 has set up an environment for businesses to face credit pressures, but I don't believe restructurings will materially increase until the economy slows down further. It needs a trigger. Strains in the housing market or continued automotive challenges may serve as a catalyst. However, new 'risk tolerant investors' in the market armed with liquidity and seemingly no hesitation to use it, will likely keep a collar on this next wave in the near term, with fewer big businesses filing overall.

Curchack: We seem to be in the pre-restructuring cycle that never ends. There is simply too much money available to rescue bad credits, at ever shrinking risk premiums. Until that liquidity dries up – for whatever reason – the cycle is not likely to change.

Hammer: Liquidity in today's capital markets remains abundant, with an ever-increasing number of non-traditional market participants (such as hedge funds with $1.4 trillion in aggregate investing power in 2006, a 29 percent increase from 2005) fiercely competing with traditional lenders to deploy capital. This competitive landscape has contributed to strong loan growth, lofty purchase price multiples in M&A transactions, and near record low loan defaults, albeit at the price of unprecedented leverage multiples and eased credit standards. The later may explain the recent flurry of hiring activity by major debtor-side restructuring firms and foreshadow a robust 'restructuring cycle' ahead.

Brown: The current restructuring cycle, as opposed to bankruptcy cycle, is mature and trending toward decline. Robust liquidity in capital markets helped mask structural flaws in the operations and capital structures of many companies. As interest rates rise, reliable returns may be realised in other markets. Rate escalations are stressing cash flows of over-leveraged enterprises and exposing junior holders to greater exposures. Current holders increasingly are seeking bankruptcy as an efficient means for dispute resolution and implementation of exit strategies.

Rosen: There is a lot of money chasing deals. And, there is more money chasing less attractive deals. Companies that may not have been financeable five years ago, are now financeable. Hedge funds and private equity firms need to put their money to work. Deals that probably never should have been done to begin with are likely to 'hit the wall' when liquidity dries up. And, there may be little patience for a traditional turnaround as opposed to a quick sale of the assets and a fast exit and re-investment.

Flaschen: We are reaching the point where I am starting to hear the prognosticators talk about the 'new paradigm of liquidity', meaning that the traditional up-and-down cycle of corporate

restructurings has been replaced by the ability to refinance out of difficulties. This is good news indeed for restructuring professionals, just as the market predictions that the internet bubble would not burst were a sure sign that that was exactly what was about to happen.

Sprayregen: How might the growth of the credit default swap market and related instruments affect future restructurings?

Brown: The expansion of these markets will make restructurings more difficult. Credit default swaps (CDS) and other derivative instruments allow parties with financial exposure to the borrower to lay off the risk to other parties in back to back private transactions. In an eventual insolvency of such borrower, the party originally holding the legal claim will not have any risk as it protected itself through the CDS market. The seller of protection under the CDS, to the extent that the CDS is physically settled, will become the owner of the claim in the bankruptcy case. The result could create enormous problems for the debtor: the creditor with whom the debtor may have worked with for a long time and potentially negotiated a work-out, is suddenly replaced with an unfamiliar entity that is likely to pursue an agenda entirely different from the one pursued by the original creditor. The situation is outside the debtor's control and the issues may increase exponentially if one holder engages in transactions with multiple parties. As a result, instead of having to negotiate with one creditor, the debtor finds itself having to deal with multiple strangers having no institutional relationship with or knowledge of the debtor, its history, affairs, needs and prospects.

Stegenga: Allowing a lender to hedge the credit risk of their lending instrument may keep the respective lender involved in the investment for a longer period and may also change the mentality of such an investor as the risk of loss has been minimised. The impact on the restructuring process may include different interests between like creditors and a more contentious environment with dissimilar creditors. A greater level of litigation is certainly at risk – protracting the time to reorganise, increasing the cost and possibly impairing business performance longer than would be expected.

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STUART M. BROWN

Flaschen: In truth, they will not have much of an effect at all in my view. Large corporate restructurings have become less and less focused on debt instruments and more and more focused on the debt players. CDSs and LCDSs are primarily bought by hedge funds and prop desks, and these same funds and desks also buy into the first and second lien loans, the senior and subordinated bonds, and even the equity of distressed companies. As a result, while a CDS may be a different vehicle, it will be driven by the same investors who increasingly drive the other debt and equity instruments of a distressed company.

Hammer: Whereas credit default swaps may improve liquidity and transparency in the market, they may also create perverse incentives for counterparties to prefer restructuring outcomes that maximise the value of their swap position as opposed to their underlying debt investment. For example, a credit swap may cause a senior lender to reject an otherwise workable out-of-court solution, simply to maximise its swap investment in the resulting Chapter 11 case. To be sure, the proliferation of credit default swaps stands to inject further uncertainty in reorganisation processes.

Allison: Greater transparency and liquidity may cancel the need for in-court restructuring except for union contract and mass tort issues as par values on junk debt is re-traded.

Curchack: The new generations of derivatives (CDOs, CDSs, etc.) have had a tendency to hide the true economic fallout from bad credits by appearing to hedge, and spread the risks of default. When the cycle does turn down (as it will) there may be a domino effect, resulting in defaults in unexpected places. And with many of these structured synthetic deals, there will be nothing to reorganise, rather there will simply be a total meltdown of the credit.

Sprayregen: What role will hedge funds and other 'non-traditional' sources of debt play during the next bankruptcy wave?

Rosen: Hedge funds that made questionable investments will need to restructure them. They will see large portions of their equity/investment wiped out unless they reinvest. Non-traditional lenders such as hedge fund affiliates will compete to a greater degree with traditional lenders for new financing opportunities where the returns are attractive. We may see hedge funds become even more active in DIP financing as a means of realising high returns and because the funds are comfortable with converting debt to equity as an exit strategy. More hedge funds may purchase distressed paper and also claims that are lower in the debt structure (such as second liens) as a means of taking control.

Hammer: Hedge funds and other non-traditional players should have a very significant role in the next bankruptcy cycle, as both debt and equity investors. They should also increasingly participate in bankruptcy asset sales, compete with traditional DIP lenders – making the DIP financing market more competitive, and continue to pursue out-of-court solutions with distressed companies to avoid the administrative costs and business interruptions inherent in Chapter 11 proceedings.

Allison: These new and powerful actors will come early and stay late, blurring the traditional roles of parties in interest. The values

lost in Chapter 11 and transaction costs will be absorbed by these new participants. Hedge funds, private equity, and other non-traditional sources of debt will have a major influence on the way Chapter 11 reorganisation will be used in the future. Given these sources of debt may control many classes of creditors, the use of Chapter 11 may become more tactical in nature. Moreover, cases will become more compressed. Finally, to the extent that assets will become available, I see increased use of the 363 sale mechanism.

Stegenga: Hedge funds and other less-traditional sources will continue to provide liquidity to companies at all levels of the capital structure. Many will 'loan to own' and exercise strategies focused on the controlling tranche of the debt food chain. In addition, they will continue to purchase distressed debt, as well as provide DIP and exit financing alternatives. I believe their roles will only increase in the next wave of significant restructurings. These financing sources are here to stay.

Flaschen: Distressed debt and equity investors are the purest capitalists in the restructuring world. For them, different parts of the capital structure are just different forms of currency, and their focus is on what they can buy with that currency, rather than on historical relationships or future lending opportunities. This leads to a greater emphasis on faster value maximisation and realisation, whether through pushing for a sale, a cash-out via an exit refinance, or a loan-to-own takeover.

Curchack: We have already witnessed an uptick in litigiousness among the new players in the distressed arena. This trend will only continue as new money chases the opportunity for an opportunistic trade. The trend towards short term trading opportunities as opposed to longer term investing by creditors committed to a particular debtor may make it harder to find large creditors willing to accept the fiduciary responsibilities that accompany sitting on a creditors' committee and so make it more difficult to manage a large and complex Chapter 11. Put another way, there will be more interest in short term fluctuations in the pricing of claims, and less concern about the long term viability and reorganisation of the debtor.

Brown: There are recent court decisions requiring counsel representing multiple parties fully to disclose the identity of their clients, the nature and extent of their clients' holdings and their clients' investments in their holdings. Many think that these decisions will drive alternative funding sources from participation in bankruptcy cases, however, the impact of these decisions is merely to limit the number of clients represented by counsel to one. As with all cycles, parties with liquidity are well-positioned to take advantage of others' misfortunes. So long as alternative funding sources remain liquid and insolvency-related returns, both debt and equity, continue to outpace other segments, alternative funding sources will continue to devote at least a portion of their portfolios to distressed investments.

Sprayregen: In light of the significant introduction of second lien debt to capital structures, what added pressures will intercreditor arrangements bring to future restructuring processes? Have there been any recent cases where second lien lenders have experienced a negative outcome?

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WALTER H. CURCHACK

Hammer: Borrowers under second lien facilities may experience adverse indirect consequences from protracted disputes between first and second lien lenders. In out-of-court workouts, first lien lenders may push their borrowers beyond the brink in seeking to extract enhancements to intercreditor rights from second lien holders. In formal proceedings, litigation of first impression as to the enforceability of certain intercreditor rights stands to make bankruptcies more protracted and expensive for all parties. To illustrate, after much costly litigation, the *Aerosol Packaging* court recently disenfranchised a second lien holder from voting on the debtor's plan on account of its pre-bankruptcy assignment of voting rights to the first lien holder.

Allison: Second lien holders have changed the dynamics of the balance sheet. Classic restructurings involved money centre banks, institutional lenders that had a clear agenda. The interest of the second lien holder may be varied from a valid lien holder to a position that will eventually convert debt into a controlling equity position. Second lien lenders with material positions will bid-up their exposure to acquire controlling interests. The position of creditors groups may vary as debt is bought and sold. Large creditor bodies today may have a conflicting agenda based on the price at which they purchased the debt, as well as differences in desired outcome. There is a greater likelihood that during the period a committee is operating that significant claims are traded or sold to buyers who have short-term economic horizons. As a result, committee professionals may be asked to take positions that drive trading values rather than long-term restructuring factors.

Flaschen: Until recently, everyone had their own form of first/second lien intercreditor agreement and they varied in the level of restrictions imposed on the second liens. Distressed investors buying into second liens have been surprised at how restrictive the intercreditor agreements have been, leading to a fair amount of bankruptcy litigation over especially burdensome or ambiguous points. Interestingly, this has helped drive a homogenisation of intercreditor forms, and rather than being more equitable in order to address second lien investor concerns, the forms have become even more restrictive in order to reduce further the ability of second liens to have a meaningful voice in restructurings.

Brown: Second liens permit borrowers to stretch their balance sheets by increasing the amount of leverage available. In bankruptcy, second lien lenders seek current payment of interest as adequate protection and otherwise to leverage their liens to the potential detriment of the senior secured lenders and the borrowers. The result is potentially decreased liquidity for debtors and a greater likelihood that bankruptcy cases will be burdened by additional costs and delays occasioned by intercreditor litigation. In one recent case the debtor was forced to liquidate to the detriment of all constituencies, because the senior and second lien holders failed to reach an agreement.

Stegenga: Second lien debt has not been stress tested yet. The explosive growth from 2001 (almost non-existent) to 2006 (more than $25bn in volume) has occurred during a period of relatively low defaults. Sophisticated entrants implementing 'loan-to-own' strategies are negotiating improved positions through deal-specific intercreditor agreements. That will continue. In many instances, they are earning the fulcrum position and are truly driving case recoveries. However, not every second lien deal has been perfect. For example, Meridian recoveries fell a little short of expectations.

Curchack: Calling a credit secured does not make it so. Many so-called second lien positions will be the subject of challenges from both above and below in the capital structure. Valuation issues will likely arise much sooner in a case as the struggle to identify and control the fulcrum class of securities becomes a key driver. This will likely be coupled with litigation over the enforceability of the next generation of intercreditor agreements. Finally, the concept of 'gifting' between classes, as was recently addressed in the *Iridium* case, will be hotly contested.

Rosen: Second lien creditors will find themselves in the same boat as trade creditors and unsecured noteholders. However, their claims will be much larger and they may effectively dominate the unsecured creditor class. Second lien creditors that are 'underwater' may seek to purchase larger numbers of other unsecured claims in order to obtain leverage in the case. When it comes to a reorganisation plan, holders of large positions in second liens may be willing to accept treatment that trade creditors often shy away from – such as equity.

The biggest change I have seen is the increasing divergence of views within large creditor groups, related in part to the increasing inexperience of newer group members.

EVAN D. FLASCHEN

Sprayregen: How have the dynamics of representing large creditor groups versus individual creditors changed in recent years?

Curchack: There is much less commonality of interest among creditor constituencies. People holding the same class of claim are likely to be in the credit at different bases and with different return expectations, making it harder than ever to develop a consensus.

Rosen: Today a creditor committee is likely to be composed of a more diverse constituency with very different interests. For example, a committee today may have members from the labour union, the PBGC, traditional trade creditors who want to continue doing business with the debtor post-bankruptcy, traditional trade creditors who do not care if they continue doing business with the debtor post-bankruptcy, bondholders who paid par for their claims, bondholders who purchased their claims at a discount from par and an indenture trustee. Each of these interests may have a different goal for the reorganisation case.

Flaschen: The biggest change I have seen is the increasing divergence of views within large creditor groups, related in part to the increasing inexperience of newer group members with the Chapter 11 process due to the dearth of large filings over the last several years. This makes it all the more critical for counsel to stay in constant communication with the entire group, not just the most vocal members, and to be more detailed in discussing Chapter 11 legal issues and court dynamics.

Hammer: Creditors are increasingly organising themselves on an informal basis for strategic purposes, as well as to share information and cost, in bankruptcies and restructurings. These ad hoc (or unofficial) creditor committees have been highly successful in recent years in influencing the outcome of bankruptcy proceedings, such as in the United Airlines case, in which a group controlling almost 200 aircraft extracted a favourable settlement from the debtor by bringing substantially greater leverage and resources to the table than if these creditors were acting individually. Courts and restructuring professionals, however, continue to grapple with various disclosure and potential conflict issues that permeate the representation of ad hoc creditor committees.

Brown: Bankruptcy courts in a growing number of cases and circumstances are enforcing the dictates of Rule 2019 that requires the disclosure of the identity of each party represented, as well as proprietary information of such parties, potentially to their detriment. We are seeing this rule used by debtors as a shield in various asbestos-related cases and as a weapon in cases where alternative funding sources combine and seek to be represented by one counsel. As a result, ad hoc committees and other combinations of interests are losing their leverage and cases are becoming less efficient.

Sprayregen: What factors are driving the use of litigation in bankruptcy cases? Do you expect this to continue?

Stegenga: The main factor that I believe will drive litigation is the increasing complexity of capital structures. Welcome to the world of third lien toggle, 'covenant lite' investing. Valuations will be critical as the fulcrum security is defined. Unsecured

Creditor Committees (UCC's) will need to accept the presence of ad hoc groups as a constant. Litigation trusts will continue to be important Plan currency for certain constituents. This increasing complexity is simply bringing more parties to the table. And all will have advisers.

Curchack: Litigation has always played a major role in reorganisation, but it is now being much more aggressively pursued for its own sake, as a means of driving the market price of claims, and leveraging one's position in the capital structure for additional settlement value by emphasising the risks of delay and the expenses of litigation.

Flaschen: Chapter 11 has always been a game of leverage, which historically compelled the parties to the negotiating table to bang out a consensual reorganisation. Debtors started to become more litigious, however, seeking to use their natural bankruptcy court advantage to intimidate creditors into accepting a less favourable result. But the tables have been turning, with creditors saying 'two can play at that game' and becoming more litigious on a proactive basis.

Hammer: Litigation in bankruptcy cases is being driven by debtors and creditors' committees, which seek to avail themselves of causes of action that are unique to bankruptcy, such as claims for deepening insolvency and equitable subordination against the debtor's pre-bankruptcy lenders. While the trend of the US bankruptcy courts in recent years appears to be against deepening insolvency as a stand-alone cause of action, this theory remains credible or untested in many jurisdictions. Further litigation in this area should be anticipated until the courts reach a consensus on the viability of deepening insolvency claims.

Brown: Bankruptcy courts are proven, efficient and effective forums for dispute resolution. Moreover, these courts are predictable. Litigants benefit from these attributes, therefore, bankruptcy courts can be expected to be the forum of choice for litigation. With the enactment of BAPCPA and changes in the capital markets to include so many unregulated alternative funding sources and increasingly sophisticated credit products, parties involved in bankruptcy cases face new and untested issues that have been and will continue to be litigated before the bankruptcy courts for years to come.

Rosen: Bankruptcy litigation has become more sophisticated. It is much less informal than 20 years ago. It now more closely resembles litigation in the federal District Court. As cases grow larger, this trend will continue. Many litigants still perceive the Bankruptcy Court as debtor friendly or as the debtor's home court. Litigation in the Bankruptcy Court may become increasingly attractive in the mega cases where thousands of jobs are at stake and where the Bankruptcy Court can be particularly concerned about the implications of a decision on the debtor's reorganisation.

Allison: Chapter 11 has been an ideal mechanism for resolving mass tort litigation. Today the field is set for intercreditor litigation, given the varied nature of lenders agendas. Litigation has also taken the direction of board members, a look into the deepening insolvency theories and fiduciary obligations. Significant new factors arising in bankruptcy cases relate to changing roles of economic participants, such as adequacy of disclosures, champtery and intercreditor agreement disputes and will continue to drive bankruptcy litigation.

Everyone is working to shorten the time in bankruptcy due to the inherent costs of administration. And early statistics on the number of recent pre-packs appear to suggest BAPCPA is contributing to that.

JEFFERY J. STEGENGA

Sprayregen: With the introduction of BAPCPA in October 2005, companies have faced challenges with respect to shortened timeframes and other restrictions affecting their ability to restructure in Chapter 11. What effect do you believe this has had on business bankruptcies over the last 12 months?

Brown: In light of the limited number of business bankruptcies that were filed in the last 12 months it is hard to say whether BAPCPA has had any impact on case strategies or outcome. Most bankruptcy cases that I see are filed with an exit strategy either in place or significantly far along in the development and implementation stage that the cases are administrated relatively quickly. Few and far between are the manufacturing cases that are filed with a view of operating under the protections of the Bankruptcy Code indefinitely. However, BAPCPA has impacted retail cases most notably by shifting some of the leverage and value to the landlords.

Rosen: The reduced length of time within which to assume non-residential real estate leases in retail Chapter 11 cases has made pre-planning essential in such cases. Retailers now must make faster decisions on which stores are 'keepers'. When in its annual revenue cycle, a retailer that commences its Chapter 11 case is much more important. Gone are the days when the retailer can sit back and say 'Let's see how the store does next season before we decide whether to close it or sell it.' The provisions of 503 (b) (9) that gives vendors a 20 day administrative claim means that confirming a plan without a significant pot of money for administrative creditors (not to mention reclamation claims and professional fees) can be very difficult in a thin case.

Stegenga: Everyone is working to shorten the time in bankruptcy due to the inherent costs of administration. And early statistics on the number of recent pre-packs appear to suggest BAPCPA is contributing to that. However, one of the bigger BAPCPA issues appears to be how code section 503(c) regarding executive compensation is being applied. Rulings such as Judge Lifland's *In re Dana Corp*. that executives cannot be paid to stay, but must meet incentive targets that are not easily satisfied, will directly

impact a key issue on the retention of key executives during the post-petition period.

Hammer: With business bankruptcies near historical lows, BAPCPA appears to have kept bankruptcy filings down over the last 12 months. But the relatively strong US economy, coupled with abundant liquidity, may have significantly contributed to the low filing rate. As the business cycle trends downward, and as the capital markets tighten, the restructuring community can better assess how the shortened timeframes and other restrictions under BAPCPA have affected the level of corporate bankruptcy filings.

Curchack: The relatively low level of Chapter 11 activity has mitigated the full impact of the changes introduced by BAPCPA. I don't think BAPCPA has lead to the decline in filings. Indeed, in those cases which have filed since October 2005, the largest impact of the new law has been the changes in executive compensation, but even there, creative lawyering and practical wisdom by bankruptcy judges has resulted in the retention (and compensation) of key management by most debtors.

Flaschen: Chapter 11 does not create value, it only redistributes it, so I think the BAPCPA amendments have had a positive effect overall. Chapter 11 should be an emergency room, not a long-term care facility, and the shortened timeframes have sharpened the focus of management and the professionals on the need to perform the business and balance sheet operations more quickly so that the patient can get back on its feet sooner.

Sprayregen: Have any recent cases provided an insight into the working of BAPCPA in practice?

Flaschen: A BAPCPA amendment that I particularly favour is the ability to seek an appeal directly to the Court of Appeals from the Bankruptcy Court pursuant to the new 28 USC § 158(d)(2). Given the fast pace of Chapter 11 cases compared to normal litigation, the need for all appeals to go through the District Court (or BAP) before reaching the Court of Appeals often proves the old adage that 'justice delayed is justice denied'. The ability to appeal directly to the Court of Appeals will, if the appeal is accepted, help address this problem. In fact, the Fifth Circuit just accepted a direct appeal of an important and time-sensitive issue involving whether the debtor was a 'single asset real estate' debtor, in *Ad Hoc Group of Timber Noteholders v. Scotia Pacific Co*.

Trade creditors seeking expanded reclamation and administrative claims have been frustrated by crafty debtors in large cases from actually getting paid on those claims.

AARON L. HAMMER

Allison: In a recent case we were able to move through the Chapter 11 process very quickly – from petition to plan confirmation took 9 months. I would anticipate that most cases will move through the Chapter 11 process at an expedited rate. We will see greater planning prior to the filing of a Chapter 11 petition in order to more effectively utilise the process.

Curchack: *Refco*, the first mega case filed after (or to be more precise, on) 17 October 2005, the effective date of BAPCPA, showed that you can achieve a plan quickly and still manage the increased information flow to creditors mandated by the new law without jeopardising truly confidential information. *Dana* showed that, with respect to retention payments, even if you don't get it right the first time, you can still get it done.

Rosen: Recently, in the Adva-Lite bankrutpcy case in Wilmington, much energy had to be devoted very early on in the case in an effort to resolve reclamation claims and 20 day administrative claims because the Court made it clear that it might not approve a 363 sale if the debtor would not ultimately be able to confirm a plan of reorganisation (liquidation).

Hammer: In the almost two years since BAPCPA took effect, creditors have experienced mixed results in enforcing newly granted bankruptcy rights. For instance, trade creditors seeking expanded reclamation and administrative claims have been frustrated by crafty debtors in large cases from actually getting paid on those claims. By contrast, utilities seeking tangible 'adequate assurance' payments have been successful in obtaining court orders that require debtors to provide deposits or prepayments to the utilities as a precondition to continued service, even in wholesale situations such as *Forte Communications* (N.D. Ill.) and *Trinsic, Inc*. (S.D. Ala.).

Brown: From a commercial perspective, BAPCPA is relevant most notably in three contexts: Chapter 15, retail leases and executive bonuses. BAPCPA introduced an entire chapter of statutes to replace a single section under prior law. The intent was to standardise practice internationally, but with only a few examples in place to date, any insight remains hazy. BAPCPA materially altered the lessor/debtor relationship in bankruptcy by shortening the time a retailer with many locations could restructure its business or sell its business as a going concern or sell its leases in a package through designation rights offerings. Landlords no longer are forced to sit idly by while their properties are hawked exclusively for the benefit of the estate over potentially extensive periods. A couple of recent retail cases have demonstrated the friction between old practices by debtor retailers and landlords' newfound rights. Finally, BAPCPA appears to have curtailed the perceived abuse of high-level executives taking their final mammoth slices, leaving only crumbs for general creditors. BAPCPA appears to be rationalising the extent of bonuses (smaller and success-based) and the parties receiving bonuses in bankruptcy cases (bonuses deeper into the employment pool).

Sprayregen: Has an increase in exposure to potential liabilities, such as negligence and malpractice claims, changed the way today's turnaround and bankruptcy professionals approach new engagements?

Rosen: Turnaround professionals today must keep an eye on pension claims, officers & directors claims and mass tort claims to a degree never anticipated 10 years ago. D&O claims now are commonly pursued. Even comptrollers of various states of the US do not hesitate to pursue such claims if necessary to achieving a fair recovery. The size of pension claims become a paramount issue when the debtor and the committee are evaluating a traditional reorganisation, the sale of the debtor's business as a going concern or liquidation. A chief restructuring officer must exercise much greater caution so as to not become liable for such claims as a result of his/her exercise of control over a debtor.

Allison: There has been a need to replace existing management in most restructurings. The role of CRO has expanded as has the need to provide the restructuring firm with the proper safeguards and indemnities.

Hammer: Professional liability issues are always on the minds of turnaround and bankruptcy professionals. However, I can speak for myself and the overwhelming majority of my colleagues in the US restructuring community in stating that regardless of the current litigation environment as it relates to professional liability, the community at large exercises the utmost due care in performing their engagements. With trustees often viewing restructuring professionals as potential 'deep pockets,' however, the spectre of professional liability permeates every engagement and should be taken very seriously.

Brown: Generally speaking, I am not sure that there is an increase in exposure. Lawyers and other professionals are generally subject to the same duties imposed outside of bankruptcy. So I must say that the answer is no, since I don't see an increase in exposure, I have not seen a change in the approach. Highly skilled professionals continue, as they always did, to due diligence the engagement and the client before they agree to take on the assignment, be extremely vigilant in conducting comprehensive and diligent conflict searches, err on making more rather than less disclosure, while at the same time attempt to reduce their exposure to litigation by seeking to obtain releases, indemnities and exculpation in confirmed plans of reorganisation and in the bankruptcy court orders approving their retention.

Sprayregen: Despite widespread corporate optimism, what sectors would you say have continued to demonstrate structural weaknesses?

Allison: The healthcare field continues to face challenges. When federal budget deficits are high, one usual avenue for balancing the budget is a reduction in healthcare reimbursement. Look to this fall when the federal budget comes together to see which sectors of the healthcare field are adversely impacted by reduced reimbursement levels.

Brown: Traditional US commodity manufacturing continues to expose its underbelly to high wages and petroleum prices domestically. Specialty, value-added manufacturing, in contrast, appears to be holding its own. Increased interest rates have begun to eat away at consumer confidence and as the slow down in housing ripples through the US economy, I suspect retail will suffer as well.

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KENNETH A. ROSEN

Hammer: Aside from the obvious one – automotive – I would not be surprised to see further weakness in the home construction industry and related suppliers, with homebuilder confidence at a 16-year low and the subprime mortgage industry in shambles. Certain segments of the telecommunications industry, specifically resale, also continue to demonstrate significant structural weaknesses. Many resellers simply cannot compete against the incumbent local exchange carriers in light of several recent federal court decisions and administrative rulings that turned the wholesale market for telecommunications services on its head.

Rosen: Retailers are particularly vulnerable to Wal-Mart, Target, Kohl's etc., who have drawn customers away from traditional department stores and specialty stores. Specialty stores such as Toys "R" Us and Pier 1 may lose market share as discounters carry more stylistic items and consumers are more focused on price. Domestic manufacturers will continue to decline because manufacturing in Asia continues to draw away jobs. American manufacturers of furniture, textiles, automobiles, electronics are but a few examples.

Curchack: There are certain industries that, by their nature, are more susceptible to distress. For example, any industry with high fixed costs that is also sensitive to unstable commodity prices and competitive pricing (airlines and telecommunications are two examples) will always be at risk.

Sprayregen: Over the last couple of years, the automotive supplier industry has been suffering from rising commodity costs, falling production volumes and continued pressure from the OEMs. Has this industry stabilised itself, or will the issues in Detroit continue?

Stegenga: Although private equity investors have recently made significant investments in the North American supplier market, and even in the OEMs themselves, the industry continues to struggle. Global competition, excess capacity, pricing pressures and production cuts from the Detroit OEMs have not gone away.

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Combine these factors with escalating healthcare costs, significant legacy liabilities and reorganisation uncertainty surrounding several key suppliers and OEMs, and there is limited evidence suggesting that the automotive industry has even remotely stabilised itself.

Brown: While some have stabilised in bankruptcy, suppliers reliant on US auto-manufacturers face continuing price and margin pressures as the Big Three continue to right-size factories and models. Moreover, this industry is exposed to commodity price and infrastructure pressures and is heavily unionised, which means it suffers from legacy costs that could affect value and performance. It also appears that private equity firms are targeting this sector, which may lead to creative solutions for these legacy costs. Moreover, as Detroit continues to restructure, it is foreseeable that the suppliers will suffer continuing losses and distress, however, advances by foreign manufacturers domestically may stem this tide.

Rosen: Most likely there may be consolidation in the American auto industry – perhaps fewer manufacturers; but certainly fewer plants. The industry will have to reinvent itself. Models may be more limited. Pension costs will have to be reduced and wages must inflate at a reduced pace in order for domestic manufacturers to become competitive on labour costs. A job in the auto industry may no longer have the security that it once had. Unions will have to make concessions.

Hammer: By no means has the US automotive supplier industry stabilised itself. Detroit continues to face stagnant or declining demand for its products, and still unresolved legacy healthcare and pension issues stand to bring the Big Three automakers to their knees. Meanwhile, competitive pressures are at an all-time high, as evidenced by Toyota's recent ascension to the throne in the global automobile market, thereby pressuring Tier 1 suppliers to make substantial price and volume concessions to the OEMs. Additional supplier restructurings and liquidations should be expected in the near term.

Allison: Detroit automakers will no longer produce the same volume, however there is a potential for replacement as foreign automakers increase US manufacturing, provided parts suppliers can make necessary efficiency improvements. The industry needs to retool to be competitive in light of rising fuel costs and the demand for fuel efficient vehicles. At some point, further rationalisation may take place with respect to old technologies, while their may be several opportunities for growth with newer more innovative technologies.

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THOMAS J. ALLISON

Sprayregen: Do you anticipate an imminent rise in cross-border restructuring carried out under U.S. processes? What particular strategies, legal considerations and other issues will separate forthcoming cases from those of the past?

Curchack: As more countries adopt debtor-friendly restructuring schemes, and Chapter 11 becomes less so, it seems unlikely that there will be a surge in cross-border cases coming to the US as the most favoured forum. However, when politics or corruption are alleged to be factors in a case, it is likely that debtors will seek out the US courts, but will find the jurisdictional issues hotly contested early in the case.

Flaschen: My experience is that US-based restructurings are decreasing, not increasing. While there have always been a sprinkling of section 304 filings, and now Chapter 15 filings, the most significant cross-border cases have involved Chapter 11 filings in order to take advantage of our reorganisation procedures. However, more and more countries are adopting their own reorganisation-friendly statutes, reducing the need for Chapter 11 protection.

Brown: US processes likely will only drive out-of-court, cross-border restructuring if US interests are the most significant involved. Processes in all major business centres have evolved and become more globalised, aided by regional and multinational insolvency regimes and national adoption of some form of the UNCITRAL standards for cross-border proceedings. The resultant new and varied legal and business regimes, and their interplay, will in great part shape the issues, parameters and requisite strategies.

Rosen: Cross-border Chapter 11s will be on the rise. This is partly the result of increased foreign investment in the United States. It is also the result of the increase in size of large American Chapter 11 cases – many of which have operations and subsidiaries spanning the globe. There may be greater investment in American manufacturers by foreigners who see opportunity in America's distressed manufacturing industries.

Hammer: While I do not predict an imminent rise in cross-border restructurings, given the global nature of the modern economy, cross-border cases will be the norm as the market turns. As more foreign debtors initiate recognition proceedings under new Chapter 15, bankruptcy courts will be asked to define the scope of Chapter 15 relief, among other things. For example, will bankruptcy courts recognise foreign orders approving post-bankruptcy lending that contain priming liens on the pre-bankruptcy lender's US collateral under Chapter 15, absent a hearing on adequate protection under section 364(d), or will the courts require a full-blown Chapter 11 proceeding to protect the lender's rights? Many other similar cutting-edge issues exist in today's cross-border restructuring world. ■

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