

## ALERTS

## ABI Commission Report: Highlights of Proposed Chapter 11 Reforms

**December 8, 2014**

The American Bankruptcy Institute (“ABI”) Commission to Study the Reform of Chapter 11 issued today a 400-page report (the “Report”) recommending changes to Chapter 11 of the Bankruptcy Code (“Code”). The Report is the result of a two-year effort by 150 practitioner-ABI members.[1] Without considering the likelihood of Congressional passage in the near term, we will evaluate each significant proposed change separately in subsequent *Alerts* over the next several weeks. This *Alert* includes a non-exhaustive list of the ABI recommendations that, if enacted, would most affect our clients involved with DIP lending and Section 363 sales.

### DIP Loans

- No “roll-ups” (i.e., using DIP loan proceeds to pay down, in whole or in part, prepetition secured claims) unless: (1) the DIP facility is provided by new lenders who do not hold the prepetition debt that will be paid down; or (2) the DIP lender extends “substantial new cash” and provides “more financing on better terms than alternative facilities offered to the debtor” (Report, at 73); and if roll-up is permitted, it cannot be effectuated until the final financing order. (Report, at 80).
- No DIP lien or DIP claim on avoidance actions or proceeds. (Report, at 73).
- No case “milestones, benchmarks, [or] similar provisions” during the first 60 days (e.g., deadlines to conduct a sale, obtain entry of an order

approving bid procedures or obtain approval of plan support agreement). (Report, at 73).

- No waiver of Section 506(c), which allows a DIP/trustee to surcharge a lender's collateral. (Report, at 226).
- No waiver of Section 552(b), which allows the court to "limit or terminate" a "creditor's prepetition lien on postpetition property of the estate." (Report, at 230).
- No lien or claim acknowledgements in interim financing order. (Report, at 80).

## Section 363 Sale of "Substantially All Assets"

- No sale of substantially all of debtor's assets in first 60 days of the case unless debtor can show "by clear and convincing evidence that there is a high likelihood that the value of the debtor's assets will decrease significantly during the 60-day period." (Report, at 83).
- Out-of-the-money stakeholders (referred to as the "Immediately Junior Class") are entitled to a portion of sale proceeds on account of "the future possibilities" that the "junior class might have been in the money or received a greater recovery if the firm had been valued at a later date," which is referred to as the "Redemption Option Value." (Report, at 208). The Redemption Option Value attributable to Immediately Junior Class "should be the value of a hypothetical option to purchase the entire firm with an exercise price equal to the redemption price [which equals 'the full face amount of the claims of the senior class, including any unsecured deficiency claim, plus any interest at the non-default contract rate plus allowable fees and expenses unpaid by the debtor'] and a duration equal to three years after the petition date." (Report, at 219). The Redemption Option Value would be valued "using a market-based method such as the Black-Scholes model ... ." (Report, at 221). The "bottom line implications" of this rule would be that "where the senior class distribution" results in close to payment in full, the immediately junior class is likely to be entitled to some Redemption Option Value. On the other hand, where the senior class is deeply impaired," the Immediately Junior Class " is likely to be entitled to receive little or nothing." (Report, at 222).

- Creditors must be afforded “at least the same level of protection” in the sale process as they enjoy in the plan confirmation process. (Report, at 206). The court must find by a “preponderance of the evidence that the proposed sale is in the best interests of the estate and satisfies the following requirements” (Report, at 201):
  - Sale must comply with all applicable provisions of the Code (comparable plan provision found in Section 1129(a)(1));
  - Proponent of the sale complies with applicable provisions of the Code (comparable plan provision found in Section 1129(a)(2));
  - Sale was proposed in good faith and not by any means forbidden by law (comparable plan provision found in Section 1129(a)(3));
  - All payments made or to be made by the debtor or by a person acquiring property in the sale for services or for costs and expenses must be approved by the court as reasonable (comparable plan provision found in Section 1129(a)(4)); and
  - Sale proceeds must be reserved by the debtor in an amount sufficient to pay all allowed administrative expenses through the sale closing date (comparable plan provision found in Section 1129(a)(9)(A)).
- “Potential chilling effect alone should not constitute cause” to cap or limit a credit bid. (Report, at 146).

## Adequate Protection

- No lien or claim on avoidance action or proceeds. (Report, at 68).
- Adequate protection lien and claim to be determined based on the foreclosure value (as opposed to liquidation value or going-concern value). (Report, at 67).

## Plan

- Eliminate requirement of at least one impaired accepting class. (Report, at 257).
- “Redemption Option Value” (discussed in context of Section 363 sale) applies in context of plan confirmation. (Report, at 207).

- Cram-down interest rate is linked to market. If no market is available, then court should apply an appropriate risk adjusted rate. (Report, at 234).
- No “class-skipping” gift plans. (Report, at 237).
- Set standard for non-consensual third-party releases (Report, at 252) and exculpatory provisions for parties participating in Chapter 11 cases. (Report, at 250).
- Imposes “one creditor, one vote” rule, which “aggregates all claims in a particular class held by an entity and its affiliates that are subject to common investment management.” (Report, at 257).

## Intercreditor Agreements

- No enforcement of waiver by a junior creditor of the right to propose a non-priming DIP loan. (Report, at 73).
- No waiver or assignment of junior creditor’s plan voting rights. (Report, at 261).

## Court-Appointed Valuation Expert

- “The court should be permitted to use a court-appointed expert and to rely on hearing testimony of court-appointed expert in addition to any expert offered by the parties to assist in determining valuation issues.” (Report, at 180).

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If you have any questions concerning this *Alert*, please contact the authors or one of the following Schulte Roth & Zabel attorneys: *Adam C. Harris, David J. Karp* or *Brian D. Pfeiffer*.

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[1] The Report is available on the ABI Commission’s website.

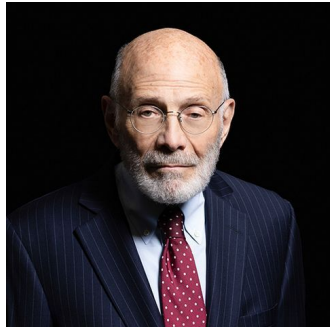
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