McTevia to Detroit Free Press: Prepackaged Bankruptcies Expedite Process

More auto suppliers looking for fast, easy bankruptcy

As Michigan's struggling companies face restructuring, more are expected to negotiate the details out of court

March 18, 2007

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FREE PRESS BUSINESS WRITER

Like many of Michigan's troubled auto suppliers, Hastings Manufacturing Co., which makes aftermarket piston rings, was on its way to bankruptcy court in 2005 after revenues fell, raw materials prices increased and debt mounted. But rather than endure an expensive, drawn-out bankruptcy reorganization, Hastings' executives sought the help of restructuring specialists who developed a sweeping reorganization plan, found a buyer, took the company into bankruptcy in September 2005 and came out in less than 90 days.

Members of the Detroit chapter of the Turnaround Management Association named it transaction of the year because of the speed and ease with which the supplier was restructured and sold. In effect, the work in selling the company -- soliciting buyers and reviewing offers -- was negotiated outside bankruptcy court.

"And once that had been accomplished, we took the company through a bankruptcy process so that the sale could occur," said Charles Moore, managing director of Conway MacKenzie & Dunleavy, a Birmingham-based turnaround firm. This type of sale also is referred to as a 363 sale, which refers to a section of the bankruptcy code.

Behind the scenes of what made that restructuring possible is a growing partnership among turnaround consultants, private-equity investors and willing company executives who are increasingly handling much of the restructuring dirty work before heading into bankruptcy court.

These so-called prenegotiated or prepackaged bankruptcies are expected to be more prevalent in Michigan as the state's struggling auto supplier industry looks for ways to bypass stricter bankruptcy laws. Under laws that went into effect Oct. 17, 2005, debtors have tighter limits on matters such as golden-parachute retention bonuses for key executives and the exclusive time to file a reorganization plan.

But the companies still need the bankruptcy court's broad, debt-shedding powers. Moore said Hastings was able to terminate the pension plan, renegotiate the labor contract and reach a settlement on retiree health care through bankruptcy court.

"In the end, the bankruptcy process was necessary because of all the obligations," Moore said of Hastings' debt. "The obligations exceeded what any buyer was willing to take in."

Pros and cons of prepacks

A prepackaged bankruptcy filing usually requires a vote on a company's reorganization plan before it enters bankruptcy court.

Assuming the company gets the support it needs ahead of time, it can file for Chapter 11 and skip many of the back-and-forth filings over what can be disclosed and which creditors get to speak in the bankruptcy proceedings. Instead, it can request the immediate scheduling of a hearing to approve the plan.

"In a prepack, the deals are cut ahead of time and all you're doing is presenting a prepackaged agreement to a judge to adjudicate," said Jim McTevia, a managing member of turnaround consulting firm McTevia & Associates LLC in Bingham Farms.

Overall in Michigan, the number of Chapter 11 bankruptcy filings has dropped significantly during the past two years, in sync with the bankruptcy law change in October 2005. For the 12 months ended Sept. 30, 2006, there were 162 Chapter 11 bankruptcies filed in Michigan, down from 247 during the previous period.

But the drop in Chapter 11 filings has meant an increase in out-of-court restructuring efforts, some of which end up as prepacks, McTevia said.

"My business activity has increased dramatically over the last 24 months, and I've been through a lot of peaks and valleys," McTevia said. "I'm busier than I've been in my 40-something-year work history."

On average, prepacks are less than 50% of the cost of a conventional bankruptcy filing, mainly because less time is spent in court.

But as a result of this shortened restructuring process, there's a greater chance some creditors will not be paid because there's less time for them to hash out differences in bankruptcy court. And prepacks can be used to make the pre-petition deal binding on dissenting creditors.

Not everyone welcomes such expediting of the bankruptcy process.

When Tower Automotive Inc. filed for bankruptcy Feb. 2, 2005, it was given the opportunity to recoup money that it paid for parts up to three months before filing for bankruptcy, which is a common bankruptcy practice.

Steve Greenman, vice president of manufacturing at Pinecrest Engineering Inc., a Traverse City-based auto supplier of specialty dies and tools, said Tower sued Pinecrest to return $250,000 it paid for tooling.

"This money was already late in delivery to us and now they want it back, declaring at the time they were insolvent," Greenman said in an e-mail to the Free Press. "This payment would most certainly put us out of business."

Another problem with prepacks is that their greatest virtue -- a very short stay in Chapter 11 -- has a downside for those companies that need more than financial restructuring, said Nicholas Kajon, a bankruptcy attorney with Stevens & Lee P.C. in New York.

Chapter 11 affords companies an opportunity to address a host of operational issues such as rejecting burdensome contracts and leases, selling noncore operations and shedding excess capacity, Kajon said. Pressing financial issues may prevent management from addressing or even fully comprehending these nonfinancial issues.

"A longer stay in Chapter 11 gives a company time to tinker with its business plan and emerge on a sound footing, both financially and operationally," Kajon said. "Thus, auto suppliers who file prepacks may solve their financial problems but fail to address equally pressing operational issues."

Speed important to suppliers

Judge Steven Rhodes, who presides over the U.S. Bankruptcy Court in Detroit, said he has not yet seen many prepacks come through his courtroom.

"Maybe two and three years ago we had a few, still a very small portion of Chapter 11s as a whole," Rhodes said.

But he's not opposed to having more.

"From the court's perspective, generally speaking, a prepack is less work," Rhodes said. "It goes through faster, and as a general rule in bankruptcy, the faster things get done, the more efficient the process is."

Restructuring speed is important to an auto supplier because while in bankruptcy court, it can miss out on new business from automakers. The effects linger, as suppliers often bid on contracts that are two and three years away.

For powertrain suppliers, a lost sale can mean missing out on a seven-year cycle, said Joseph Geraghty, managing director for the Dayton, Ohio, office of Conway MacKenzie & Dunleavy.

J.L. French Automotive Casting Inc., a supplier of die cast aluminum components used in powertrains, was on the verge of missing out on major contracts because of its trouble in the early 1990s of buying too many companies, with too much debt.

Geraghty helped shed the company's liabilities and find a buyer outside bankruptcy court. When all was complete, J.L. French of Sheboygan, Wis., filed for bankruptcy in February 2006, shed some plants and assets, and emerged in June.

"It was very critical that we accelerate the process," Geraghty said.

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