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**PRE PACK BANKRUPTCIES AND FIRST DAY ORDERS:  
I HEAR THAT FREIGHT TRAIN COMING**

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## **PRE PACK BANKRUPTCIES AND FIRST DAY ORDERS: I HEAR THAT FREIGHT TRAIN COMING**

### **INTRODUCTION**

Clearly the "go go" days have passed. Bankruptcy filings, as well as the order of magnitude of the filings, are up tremendously in 2001, 2002 and 2003 doesn't look a lot better. For my friends who are full time bankruptcy lawyers, what they refer to as the "years of terror" are finally over. It can be reasonably anticipated, and has been witnessed in my own practice, that bankruptcy filings for contractors are increasing. The issuance of new building permits in the Houston area, for commercial buildings, both with respect to new construction and repair and renovation are down over 30%. Sureties are consolidating, tightening underwriting requirements and significant players in the industry are either leaving the business or are in liquidation. Contract and commercial bond losses are huge and growing. For those of us that remember the 80's...here we go again (or here we have been going again).

If your mind hasn't been rendered completely numb by your increasing claim/case count, you may recall that, during the 90's, there was a trend in the construction industry, as well as the business community in general, for companies to go on acquisition binges. Companies got larger and larger, quicker and quicker, in order to penetrate new markets and obtain market share, obtain economies of scale and what were generally referred to as certain "efficiencies." As the construction industry is populated by small, closely held corporations, the process most frequently used was to "roll up/wrap up and consolidate" many small businesses into a larger one. The assumption was that the larger business would be better run and would achieve great cost efficiencies through vastly increased purchasing power (particularly as to insurance), centralization of accounting functions and so on.

In some cases, these "roll ups" are now failing for a variety of reasons (unrealized efficiencies, debt service due to high premium paid for the acquired corporations, reduced capital expenditure by large customers, the bursting of the "Tech. Bubble," etc.). Due to the somewhat unique characteristics of companies that have grown through acquisition, or are otherwise easy to break into marketable components, and the possible associated potential for reversing the process, a relatively new bankruptcy case has emerged - the pre-packaged fast track Chapter 11 proceeding. This paper is intended to provide a practical overview and attempt at simplification of what needs to be done, from a company representative's standpoint, when confronted with the filing of a pre-packaged/fast track Chapter 11 proceeding by its principal.

Let me take this opportunity to acknowledge my great thanks to George Bachrach, Whiteford, Taylor & Preston, LLP, Baltimore, Maryland, for his allowing me to use a reprint of the paper he presented at the Northeastern Fidelity and Surety Association Annual Meeting, a copy of which is attached to this paper. George does an excellent job on the bankruptcy issues that arise for the surety in the context of a "pre-pack," which issues, essentially, revolve around the sale of substantially all of the debtors' assets. While George often makes fun of his paper as constituting a wonderful "sleep potion," the truth is that, as usual for George, it

contains a tremendous amount of information, including forms, giving the reader an excellent beginning in his/her attempt to become familiar with the pertinent issues and procedures.

### **WHAT IS A "PRE-PACK"?**

Essentially, a "pre-pack" Chapter 11 bankruptcy filing involves the development of a complete plan of restructuring and reorganization of a troubled company, prior to any filing, whereby voluminous and sundry pleadings are developed in preparation of using Chapter 11 of Title 11 of the United States Code to accomplish the following purposes:

- To allow for the dismemberment and sale of substantially all of the assets of a business, over a very short term. (Pursuant to §362 of the Code)
- Provide for the interim survival of the business to attempt to preserve the best value for secured and, to some extent, unsecured creditors, while the debtors' only viable assets are sold.
- To afford the best possible chance of accomplishing the above goals by stopping anyone from interfering. This is done by moving so fast and giving so little notice that no one has a chance to interpose a viable objection, i.e. run over anybody in the debtors' path.
- Remove any "warts" that remain after the sale of substantially all of the viable assets or, in some cases, that are attached to the viable assets, through the bankruptcy process. Meaning, most typically, the assets that remain in the bankruptcy estate after the sale of substantially all of the viable assets, are treated under a plan of reorganization that calls for liquidation.

### **PRELUDE: WHAT HAPPENS BEFORE THE FILING AND IS THE SURETY INVOLVED?**

More often than not, the elements of negotiation and the applicable surety issues that are present prior to "pre-pack" filing are familiar to the surety representative that has participated in any work out discussions involving a large contractor. The contractor is in trouble and starts its journey by seeking credit compromises from its lenders (additional extensions of credit, modifications of existing loan agreements, waiver of various loan covenants and/or new credit facilities), in connection with a new and "sure fire" plan for restructuring. The restructuring side of the equation will typically involve the engagement of financial advisors and/or turnaround specialists, the replacement of some of the existing management, various initiatives to reduce costs, capital expenditures, and working capital requirements and most importantly from the surety's perspective, asset sales and/or a merger. In the event asset sales are contemplated, and they almost always are, the secured lender, purchaser(s), investors and contractor attempt to get a plan put together, which may or may not involve the filing of bankruptcy. Typically, the surety knows that there are trouble signs, but is not involved early on in these discussions, as the first thing the contractor needs is credit and the last thing the troubled contractor wants to do is to request additional bonds in the absence of a plan for survival. Accordingly, the surety will be called into the situation and

significant pressures will be exerted in an attempt to force the surety to go along with whatever the lender(s) and/or purchaser(s) want, which will likely involve one or more of the following:

- Additional bonding without collateral.
- Cash (to the principal or the purchaser(s)).
- Subordination of some or all of the surety's interest in contract proceeds.
- A release of the purchaser(s) from any indemnity obligations relating to losses arising out of bonds issued in connection with contracts that are not being assumed by the purchaser(s).
- The extension of surety credit to the purchaser(s), potentially, under special terms and conditions.
- Other subordinations depending on the form of asset transfer.

Of course, the above demands will be coupled with the ever present threat that the surety's failure to grant these dispensations will cause the immediate collapse of the contractor, resulting in huge incremental loss over what the surety would experience if it "goes along with the program." Moreover, the surety will often be told that the information it needs to evaluate the requested relief is unavailable, will be too costly or time consuming to produce and is of no relevance, because everybody knows that "the plan" will be better than the contractor going into default. The surety's reaction, of course, depends entirely on the nature of the terms and conditions of the proposal to the surety. What happens here will determine whether the surety will be included in the preparatory process for the filing of the pre-pack or whether it will simply be excluded and become one of that great class of creditors that will begin "to hear that freight train coming."

In the event the surety likes the plan or is otherwise able to negotiate different terms and conditions that, in the surety's view, will result in satisfactory loss and expense, the surety will get the opportunity to participate in the drafting of the various pleadings and purchase documents anticipated to be filed as a part of the "pre-pack." The surety should do so with vigor and diligence to make sure that the terms of its deal are properly preserved in the extremely voluminous and complicated filings to come. Otherwise stated as "get on the train."

In this regard, the surety will be confronted with a plethora of pleadings that purport to sell the contractor's assets free and clear of liens and encumbrances, pursuant to §363(f) coupled with 3105(a) of 11 U.S.C., which, for the surety means free and clear of its equitable subrogation interest in bonded contract proceeds. The contractor will seek court approval to pay certain critical vendors utilizing §105(a) and the "doctrine of necessity" and the surety needs to know something about which vendors will be paid and under what conditions, as the pleadings will be necessarily vague in that regard. Likewise, the contractor will seek authority to use cash by seeking approval of a post petition D.I.P. financing order or an order authorizing use of cash collateral. Either would grant a replacement lien, priming the surety's rights of indemnity and/or subrogation unless the surety is "in the game." The surety will be best advised to know and fully understand what the cash is to be used for and the nature and extent of any lien to be granted. The contractor will file pleadings relating to the deals struck with the surety and the lenders, which pleadings must be very carefully reviewed to ensure that the

surety's rights are preserved and, to the extent possible, they contain affirmations of the surety's indemnity and equitable subrogation rights. Likewise, there will be motions to sell, with numerous exhibits comprised of the purchase documents and associated schedules. These too are extremely important to the surety. There is an awful lot to look at, you will need help.

If the surety has been excluded as a result of its unwillingness to meet the terms and conditions proposed and required by the contractor, the lender(s), the purchaser(s) and others, the surety will be well advised to begin to prepare for the possibility of a "pre-pack," to the extent possible, as little time as will be given to the surety, or to other creditors for that matter, once the "pre-pack" is filed.

### **WHAT WILL OCCUR FIRST - WHAT THE HECK ARE "FIRST DAY" ORDERS? (TRAIN IS MOVING)**

All "pre-pack" bankruptcies and, for the most part, every Chapter 11 case filed in recent history involves a rush to the courthouse to file various pleadings that are designed to meet the debtor's needs in the immediate days and weeks following the filing of the bankruptcy. The term "first day order" has evolved as an identification of the various emergency/expedited motions and orders that are filed at various stages of the bankruptcy, including the first day.

If you open up your trusty paperback bankruptcy code and go to the index and look for the term "first day order," you will not find it. Without trying to bore the reader with bankruptcy speak, the "Doctrine of Necessity,"<sup>1</sup> or its functional equivalent, arises out of the application of the general and broad equity powers of the bankruptcy court, pursuant to Section 105(a) of the Bankruptcy Code, which provides as follows:

*The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process. [Emphasis added].*

Essentially, this section of the Bankruptcy Code is used to allow the judge to do whatever he/she believes is necessary to keep the Chapter 11 debtor operating while it is attempting to reorganize. These "first day orders" may authorize the debtor to spend most, if not all, of its cash. Authority may be granted to pay pre-petition debt or post-petition expenses. The payment of existing personnel will be authorized, including, potentially, incentives. The acceptance and use of credit facilities may be authorized and, of course, authority to shorten notice periods is, by virtue of the emergency nature of these motions and orders, routinely granted.

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<sup>1</sup> See, *In re Chatsaugay Corp*, 64 BR 990 (S.D.N.Y. 1986); *Michigan Bureau of Workers Disability Compensation v. Chateaugay Corp.*, 80 B.R. 279 (S.D.N.Y. 1989).

## **SHORTENED NOTICE (THE WHISTLE IS BLOWING!)**

With regard to notice, Section 102(1) of the Bankruptcy Code provides that a court may act "after a notice and a hearing" and subsection (1)(A) provides "this means only such notice...as is appropriate in the particular circumstances." The practical effect of "first day orders" is to ask for and obtain court authority for whatever the debtor needs to operate over the short term (or not so short term in some cases) and to shorten the notice period to such an extent as to preclude even the slightest possibility of a creditor developing a viable objection. It is common for the notice to arrive at the creditor's door at or about the time of the first emergency hearing. In fact, in some cases, so called "negative notice" can be granted by the court, meaning, the court enters an order granting certain interim authority, which order provides that creditors have a short period to object to the granting of the order after it is entered. One might reliably speculate as to the number of times a judge will reverse a determination on an order previously granted.

Note also that most of the hearings on these emergency motions are evidentiary hearings. (See, Bankruptcy Rule 9014, Contested Matters). Thus, if a creditor is to object, they not only have to prepare their legal arguments (usually on the same day of the hearing), but also have to be prepared to present evidence within an hour or two of receiving notice. Enough said, you get the picture, the "first day orders" will happen. Not all hope is lost however, as many bankruptcy judges will issue the orders with hand interlined reservation of rights on behalf of a creditor, if the creditor actually has notice and an opportunity to show up at the hearing, pursuant to which the order is entered. To that end, some courts have held the exercise of equitable powers under §105 are limited.<sup>2</sup>

"First day orders" are entered to grant interim authority pending a final hearing on the corresponding motion. Guess what, notice of the final hearing is also shortened, but, generally, is at least a week to ten days. Practically speaking, the period between the granting of the emergency interim order and the final hearing amounts to an opportunity to negotiate the specific terms that the surety wishes to have included in the final order, based on whatever threatened objections the surety's counsel can create or advance as a pure legal argument. In other words, there will not be enough time between the granting of the interim order and the final hearing to develop the evidence necessary to address the overwhelming evidence produced by the debtors, which evidence will include extensive schedules and attachments (which must be analyzed and the proof they represent controverted), as well as the verbal testimony of its representatives and/or experts.

My father used to say there are three types of people:

- (1) Those that make things happen;
- (2) Those that watch things happen; and
- (3) Those that wonder what happened.

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<sup>2</sup> See, *Official Committee of Equity Security Holders v. Mabey*, 932 F.2d 299 (4th Cir. 1987); *In re Oxford Management, Inc.*, 4 F.3d 1329, 1334 (5th Cir. 1993).

Simply stated, if the surety is not onboard with the pre-filing negotiations and the development of the corresponding pleadings, the surety will be relegated to status (2) or (3) above in connection with the "first day orders" that are actually filed on the first day and/or week of the "pre-pack" filing.

### **WHAT DO YOU NEED TO DO?**

If the surety has been a part of the pre-filing negotiations, pleading and purchase document development, do not sit back, relax and assume that the pleadings will show up in the agreed form. Therefore, the team that the surety has selected in connection with the pre-filing matters will continue to be busy making sure that the basic reservations of rights, deal points and agreements are properly reflected in the documents actually filed in the bankruptcy. Perhaps more importantly, prior to filing, there is almost never adequate opportunity to work through all of the details of the relief to be provided by the pleadings and I believe it is safe to say, that there is never adequate opportunity to workout all of the details of the possible purchases, i.e. dismemberment of the contractor. Accordingly, the surety representative and its team of lawyers and, usually, consultants, will remain busy in the initial days of the "pre-pack" filing and throughout its progression in the bankruptcy court.

The surety is confronted with a far more difficult situation in the event it failed to come to acceptable terms with the various parties participating in the pre-filing workout negotiations. The surety representative does not know whether or not a bankruptcy filing will come, when it will come, or what the debtor will attempt to do to the surety in the bankruptcy proceeding. Consequently, if the surety believes negotiations have continued with the other parties, to the exclusion of the surety (the best indication of this is a deafening silence in response to the surety's inquiries as to what is going on), the surety should begin to assemble a team to deal with the prospective "pre-pack" and tremendous fact issues that must be investigated for the surety to make good decisions once it is filed.

### **SUGGESTED TEAM SELECTION**

At minimum, the surety's team should consist of (a) a bankruptcy attorney that is local to the jurisdiction in which it is anticipated the "pre-pack" will be filed; (b) a surety attorney; (one lawyer will not be enough); (c) a consulting firm with staffing capabilities commensurate with the size of the contractor, number of outstanding projects, and offices in which the contractor's accounting records are kept. In the event the surety was fortunate enough to obtain information during its involvement in the pre-filing negotiations, that information should be provided to the attorneys and consultants, respectively. Documents relating to the lender(s) and purchase(s) and the structure of the workout proposed up to the point of the surety's first involvement should be provided to the lawyers. Any and all accounting records the surety has pertaining to the projects, payables cash or other projections should be provided to the consultant. Simply put, anything that will clue the lawyers into what transactions were contemplated in connection with the sale of assets should be reviewed as a precursor to what may be in the pipeline for the "pre-pack". Likewise, for the consultants there is so little time to perform appropriate investigations subsequent to the filing of the "pre-pack," any financial data that might give the consultants an impression of what the contractor's payables situation is and

what the cost to complete might have been projected to be by either the contractor or the purchaser(s) is crucial to getting a head start.

The surety representative needs to keep in mind that just because the contractor and others may not have been cooperative in working out terms satisfactory to the surety during the pre-filing negotiations, acceptable terms may still be within reach. Moreover, and possibly more importantly, that asset sales under even the most marginal circumstances can be in the surety's best interest and is often much more desirable than the alternative, the collapse and default process that occurs through the "normal" bankruptcy of its contractor. Nonetheless, however, the surety representative and its team must prepare to attempt to force acceptable concessions on the part of the lender and purchaser(s) through litigating the various motions of relevance to surety.

While not being so presumptuous as to suggest that there is only one way to do things, probable tasks for the respective team members are outlined below.

### **ATTORNEYS**

- Review all pleadings and papers filed in the bankruptcy proceeding. Particular care should be given to the following:
  - motions and orders for use of cash collateral and to grant adequate protection.
  - motions and orders to obtain post petition financing.
  - motions and orders to enter into post-petition credit agreements.
  - motions and orders to authorize the payment of pre-petition debt and/or motions and orders to pay critical vendors, as may be applicable.
  - motions and orders to prescribe the form and manner of notice, (which may be filed with individual motions or a group of individual motions).
  - motions and orders to sell certain assets free and clear of liens, claims, encumbrances and other interests.
  - motions and orders approving bidding procedures.
  - motions and orders to authorize the debtors to enter into agreements regarding performance bonds.
  - plan of reorganization (and its many likely amendments).
  - disclosure statement (and its many likely amendments).
  - motions and orders to assume and assign executory contracts.
  - motions and orders to reject executory contracts.
  
- Exhibits and schedules attached to pleadings. Extensive exhibits and schedules will be attached to pleadings including the following, which are of particular interest to the surety:

- asset purchase agreements.
  - schedules attached to asset purchase agreements.
  - schedules relating to payroll and other cash requirements.
  - schedules of assumed contracts.
  - schedules of assumed liabilities.
  - schedules of excluded liabilities.
- Attendance at hearings. Until the case progresses somewhat, it is recommended that the surety have a lawyer present at all but the most inconsequential of hearings. While such hearings may not directly relate to a motion of particular interest to the surety, much information is exchanged at these hearings and it becomes a significant opportunity to discern the attitude of the judge, the position and posture of the various players and, of course, represent significant negotiation opportunities.
  - Participate in the negotiation of terms and conditions of final orders. These modifications will relate to changes in language within the motions, orders, and all the exhibits thereto, including schedules.
  - Prepare strategy for possible objections, draft objections, and prepare supporting memoranda and evidence. At some point, if things are not going well for the surety, it will be required to litigate.

Many of the above-outlined tasks will have to be simultaneously administered, with the surety representative looking to its legal team to act as part “funnel” and part “filter.” The volume and rate of filing of pleadings in a “pre-pack” bankruptcy can be astounding. Motions are often 30 or 40 pages, with the associated exhibits consuming the better part of three-inch 3-ring binders. Several such motions may be filed daily. Hence, the term “pre-pack”. In addition, everyday the debtor’s several attorneys will be busily engaged in the development of similarly voluminous pleadings and exhibits for the following week (or weeks), in an attempt to keep the estate moving and, effectively, build momentum to make it harder and harder for a disgruntled creditor to reverse or divert the debtor’s designated course. In practice, the bankruptcy lawyer will generally act as the funnel, reading and reviewing every pleading filed in the case and attending hearings, handing off to the surety practitioner the pleadings and documents perceived to have a possible impact on the surety’s interest and/or ongoing negotiations with the lender(s), purchaser(s), and/or debtor. The surety lawyer will then have to filter that information even further to present alternatives and determinations to be made to the surety representative.

Many other tasks may flow from the “pre-pack” filing. Payment claims will begin to roll in. Obligees, to the extent they have notice of problems, will begin to call. All of the other aspects characteristic of the typical large contractor default may begin to enter the picture. In other words, additional staffing capacity, beyond the core group, needs to be available to address the expanding and contracting needs of a particular case.

## CONSULTANTS

The consulting arm of the team will also have great challenges. To set the scene, the contractor and/or purchaser(s) may or may not be cooperative. Nonetheless, the consultant will be charged with the job of putting together a cogent financial picture to allow the surety a chance of making a good business decision. Particularly, in the event it is being asked to pay money to one or more parties (lender(s), purchaser(s) and/or debtor), as a part of the structured sell off of substantially all of the debtor's assets. The debtor's operations may involve huge numbers of bonded contracts, for projects situated throughout the country, administered through branch offices that are likewise situated in various cities. Additionally, the accounting functions and/or records may not have been fully centralized, meaning, to obtain even the most rudimentary information will require travel to several locations. With all of that having been said, the surety representative will still have no choice but to ask the consultant to make every effort to get the following information, at minimum:

- a very good handle on payables, on a project by project basis.
- estimated cost to complete the bonded projects, on a "relet" basis preferably.
- to perform on-site reviews for as many significantly incomplete jobs as possible.
- to establish a relationship with the purchaser(s), if possible so as to gain access to the due diligence being performed by the purchaser(s).
  - what does the purchaser(s) know about payables?
  - what does the purchaser(s) know about the cost to complete?
  - what other records of the asset component in which the purchaser(s) is interested does the purchaser(s) have?
- Obtain copies of the bonded contracts and forward them quickly to the attorney team for review.

All of the above tasks are essential to the surety's evaluation of any business offer that is the product of the "pre-pack" filing. To the extent matters can be prioritized, however, the development of a picture of what it is worth to the surety for the purchaser(s) to complete the projects and take on all of the unpaid bill obligations of the surety is at the top of the list. While it is unknown whether or not any money will be requested from the surety, it is not unlikely. The surety will not be in any position to judge the merits of the purchaser(s) proposal without this information. In addition, even if the surety is not asked for money, the surety may seek security, in the form of a blanket bond, covering all of the bonded contracts transferred to the purchaser(s), pursuant to a deal in which the surety's bonds remain in place (i.e., are not replaced by the purchaser(s)). Likewise, sizing up the purchaser(s) is important as the only security that the surety will obtain in connection with the transfer of its bonded contracts and its agreement to keep its bonds in place maybe an indemnity agreement. The surety may find

itself undersecured in the event it has not properly estimated its potential exposure in the event of a subsequent purchaser(s) default under the transferred bonded contracts. Lastly, in the event the whole scheme falls apart and the bonded contracts go into default, the surety will have to have this information in any event.

What may be even more compelling with respect to the surety establishing a relationship with the purchaser(s), is the fact that the surety will often need to take the lead in negotiating the final terms and conditions of the bonded contract assumption and assignment to the purchaser(s), unless, the purchaser(s) intends to provide each obligee with replacement bonds and each obligee agrees to accept such replacement bonds. Even if the debtor is working through the asset sale negotiations with each of the purchaser(s), the surety's involvement with the purchaser(s) is otherwise essential. For instance, the asset purchase agreements associated with the sale to the purchaser(s) may be very difficult to work with from the surety's perspective. In such event, the surety will need a separate agreement with the purchaser(s), but will still, nonetheless, have to ensure the asset purchase agreement includes certain terms and conditions, as well as closing mechanics. If the purchaser(s) does not plan on using the surety to issue subsequent bonds, some arrangement will have to be made in connection with the indemnity rights of the respective sureties as, effectively, both sureties bonds are in place for the same principal. While not true in every case, it is, generally, essential that the surety establish a relationship with the purchaser(s) very early on in the process, particularly, in cases where the surety has not been significantly involved in the negotiations that occurred prior to the filing of the "pre-pack".

### **SURETY REPRESENTATIVE**

In addition to digesting the constant flow of information he/she receives from outside lawyers and consultants and making decisions, the surety representative will have to be ready to perform some key administrative tasks:

- Identifying and providing copies of all outstanding bonds. While this may sound routine, the necessary underwriting files may take days to find and review to obtain copies of all of the outstanding bonds. The lawyers and consultants desperately need copies of the bonds in order to formulate appropriate advice. Waiting for this information can be very problematic in connection with the actions that may have to be taken in the "pre-pack" bankruptcy.
- Obtaining current claim information. Payment claim notices and default declarations can take some time to work their way through to the claims representative. If at all possible, the internal process must be expedited. Without solid claims information, you may deprive your lawyer of the most deadly arrow in his/her quiver, a viable claim of current equitable subrogation interest. The agent issuing bonds for the contractor may be the first to receive notices of claim and a call should be made to the agent to insure that the surety representative is promptly made aware of and provided copies of all such notices.

- Obtaining and providing copies of other important documents. The indemnity agreement, collateral receipt agreements, subordination agreements and/or just the knowledge of the existence of collateral can be major factors in the lawyer's pleading strategy. While it may sound like a "no brainer," the existence and production of these documents or the existence collateral is not information that seems to flow freely to the claims department. The claims representative needs to speak with the underwriter and ask these specific questions. Conversations with the agent may be helpful in this regard as well.

### **HOW DO I RESERVE THIS THING?**

As a practical matter, most surety companies require the establishment of a reserve in order to make expense and/or loss payments. If the surety representative cannot easily work with a fluctuating reserve, it may be called upon to make an early estimate of expense and/or loss reserves. In the case where the surety representative has been involved in the pre-filing negotiations, reserves will be more easily calculatable as, presumably, the required information will develop over a more customary time frame. This will allow for more precise input into and for greater thought to be given to the establishment of reserve. The calculation of reserve becomes more problematic when the surety's information is restricted to the "pre-pack" filings and whatever information the surety can obtain during the days immediately following.

Based on experience, even a mid-sized "pre-pack" bankruptcy (let's say assets in the 30 to 40 million dollar range) will require anywhere from 400 to 600 attorney hours, which estimate will increase proportionately with the number of sales contemplated and/or the intensity of adversities between the various parties. This, of course, assumes the surety is one of the major sureties for the debtor, with a significant number of open projects and associated exposure. As rates vary across the country for the attorneys that might be selected, depending on the locale of filing, experience with this specific type of case and other factors, it is left to the surety's representative to plug in an appropriate rate and do the math. Similarly, if the surety is confronted with having to hire consultants develop most of the information required to make an informed decision concerning contemplated sales, two to four consultants will likely be flying around the country and working long hours. It would not be beyond reasonable anticipation that 400 to 600 consulting man hours would be required under such circumstances. Again, plug in appropriate rate in and multiplication will take care of the rest.

Loss reserves could be far more problematic. In some instances, the surety may not incur any loss at all. All of its bonded contracts could be assumed and sold, with the purchaser assuming all of the respective bonded liabilities and successfully discharging the surety's obligations. On the other hand, the surety may be called upon to make significant cash contributions to make the assumption and assignment of the bonded contracts and the assumption of the bonded liabilities attractive to the purchaser(s). If the surety representative is making an early report to the reinsurers or

otherwise is required to make an attempt to the establishment of reliable loss reserves, the payables exposure on bonded contracts may be an appropriate indicator. Alternatively, in the event the surety obtains cost to complete projections by its principal and can establish reasonably certain contract accountings, this information, in combination with appropriate contingencies, can be used to establish a more reliable reserve.

**WHAT CAN YOU DO WHEN THINGS ARE NOT GOING WELL?**  
**(INSTEAD OF GETTING ON AT THE STATION YOU FELL ON THE TRACKS)**

In the event the surety cannot come to terms with one or more purchaser(s), but the debtor, lenders and purchasers move forward in an attempt to force a sale, the surety needs to understand that it has precious little to work with. What follows is a summary of the possible plays and the likely results:

- Object to the use of cash collateral. The idea here is that you may make the debtor and others work with you or they will not be able to use cash collateral for the various purposes provided in the debtor's motion and order. This probably will not work because of several problems. If the contracts are being performed and all the surety has received is payment bond claims, the surety's equitable subrogation interest to claim a priority in contract proceeds (the surety's portion of cash collateral) is tenuous. Moreover, you are asking the judge to, effectively, put the debtor out of business before they ever get a chance to reorganize because the debtor will not give you what you want. As a practical matter, notice will be so short that you will not be able to review the debtor's schedules, prepare a witness and have them provide compelling testimony in support of your objection, which objection will essentially have to establish that your collateral is not being adequately protected.
  
- Object to the motion to sell on the basis that the bonds that are contemplated to go along with the sale are not the property of the estate. The idea here is that without the bonds, the purchaser(s) is automatically in default under the assumed and transferred contract.
  
- Object to the motions to sell on the basis that the bonds are financial accommodations. Same idea as the immediately preceding point, namely, if the bonds are ruled to be financial accommodations, they cannot be assumed and assigned by the debtor to the purchaser(s).
  
- Object to the debtor's assumption of the bonded executory contracts. If the debtor cannot assume the bonded executory contracts, the bonded contracts cannot be assigned by the debtor. In order to carry the day at a hearing on such an objection, the surety will have to be extremely well prepared to present evidence that the debtor cannot cure all of its defaults, but that will be extremely hard to do in the context of a sale to a purchaser(s) who has agreed to assume all of the liabilities of the debtor.

- Get in the way by asserting inadequate notice. The idea here is to extend the time between the filing of the motion and hearing date, delaying the debtor's ability to accomplish what it needs to in the time frames in which it is committed to the purchaser(s) and/or lender(s). If you are not prepared to present evidence that is persuasive to the judge with respect to the matter for which you have requested greater notice, the judge will soon tire of your objections to shortened notice.
- Declaratory judgment action. This might be termed as the equivalent of nuclear warfare. What is involved here is the filing of a declaratory judgment action, naming all the bonded contract obligees, seek a declaration of the court to the effect that the contemplated sale over the surety's objection amounts to a material alteration of the surety's bond obligations which alteration results in the surety's discharge. You will now have every bonded contract obligee in the bankruptcy court which will, let us say, be viewed as undesirable by the debtor, lender(s) and purchaser(s). The trouble is it may work too well by chasing the purchaser(s) off due to the newly perceived and difficult problems it now anticipated with the respective obligees.

### **CONCLUSION**

A "pre-pack" Chapter 11 bankruptcy can be the surety's good friend or worst enemy. Each case will be as much trouble as its own circumstances dictate. Regardless, the surety representative must be prepared to act very quickly. While it may sound self-serving for the private attorney or consultant, this is not the time for this surety representative to be worried about having too many folks on the file but, instead, too few. It is also not the time for the surety representative to be consumed with authorization forms, special claim reports, or otherwise working through bureaucratic requirements that, while justified in the normal sequence and timing of events, will make it very difficult to be effective in responding to a "pre-pack/fast-track" bankruptcy. This is information, analysis and decision making at amazing speed, often relating to amazing amounts of money. In a recent Houston case, the first day "Critical Vendor Order" alone authorized the debtor to spend up to \$60 million, essentially, at the debtor's discretion, with, practically speaking, less than two weeks notice. For the private legal and consultant communities this is multi-tasking at its finest. So stock up on coffee and place a full size photo of yourself in your living room so that your family will remember what you look like when you get back from your "pre-pack" freight train ride.