Bankruptcy as a backdrop

Clay Ketter's guest column, Gavel to Gavel, originally published in The Journal Record on February 18, 2016.
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Chesapeake Energy's stock price took a hit last week after news outlets reported that it retained Kirkland & Ellis, widely recognized as one of the nation's top corporate bankruptcy law firms. Chesapeake was quick to issue a press release stating that it has no plans to pursue bankruptcy, which led to a small rebound in its stock price.

People may wonder why a company with no plans to file bankruptcy would hire an experienced bankruptcy law firm. The answer is likely prudence; the company wants to be fully informed about available options.

When companies detect potential financial trouble, it is not unusual for them to retain a law firm’s restructuring specialists to assist in assessing the situation and weighing alternatives for resolving the issue in the best possible way. That may not include filing for bankruptcy protection, but, rather, simply help in restructuring debt obligations.

When a company experiences financial stress, there is value in thoroughly preparing a well-thought-out plan to address the problem, which often involves developing a bankruptcy strategy as a point of reference and being prepared to file, if appropriate. With a bankruptcy scenario as a backdrop, a company and its restructuring advisers typically attempt to work with the company’s creditors to restructure their agreements in a manner more favorable to the creditor than they might receive in bankruptcy. Ideally, this would allow the company to get back on the right financial track and, ultimately, to make things right with its creditors without a bankruptcy filing.

Creditors of large corporations, usually sophisticated financial institutions, will be aware that restructuring specialists are prepared to put the company into bankruptcy for its protection should an alternative agreement not be reached. However, bankruptcy can be a disruptive, risky process that does not always yield the best outcome for either side. Risks on one side include company ownership being transferred to the creditors, and on the other, the creditors’ recoveries being less than what they might have recovered in the absence of a bankruptcy.

Thus, bankruptcy considerations often educate and motivate both sides to work together to find an out-of-court solution to their debt issues and, thereby, avoid bankruptcy altogether.

However, in situations where parties are unable to come to terms, the due diligence done by the company and its restructuring advisers can be used to take appropriate action to protect the company and its interests.