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# The "Reinstatement" Trap of Section 1124 of the Bankruptcy Code.

In the not so distant past, when credit was relatively cheap and readily available, financially distressed companies often used Chapter 11 as a means to restructure and replace their existing secured debt. However, with financing generally more expensive than in past years and less available, a company entering Chapter 11 might today, much to the surprise of its lenders, instead seek to "reinstate" its pre-Chapter 11 secured debt upon exiting Chapter 11 so as to preserve the more favorable financing terms it received when lenders were more aggressive. As strange as it might seem, the reinstatement of pre-Chapter 11 debt upon an exit from Chapter 11, as an alternative to refinancing, is possible as a result of Section 1124 of the Bankruptcy Code.

Section 1124 of the Bankruptcy Code permits a Chapter 11 debtor to "reinstate" a pre-petition debt on its original terms, and without the consent of the lenders, as part of a Chapter 11 plan. Until recently, however, a Chapter 11 debtor had little incentive to utilize Section 1124 in this manner as refinancing was more often than not a cheaper alternative.

In order to reinstate a pre-petition loan or other debt under Section 1124 of the Bankruptcy Code, Section 1124 requires that (i) the Chapter 11 debtor cure any existing defaults under the applicable loan documents and (ii) the proposed plan of reorganization does not violate the applicable loan documents.

Given the broad range of default provisions contained in many loan documents, reinstatement under Section 1124 of the Bankruptcy Code is no sure thing. However, as evidenced by the recent bankruptcy case of *In re Charter Communications*, 419 B.R. 221 (Bankr. S.D.N.Y. Nov. 17, 2009), it can happen.

When it filed for Chapter 11 in March 2009, Charter owed approximately $11.8 billion to its secured lenders under a pre-petition credit facility. The interest rate payable by Charter under the pre-petition credit facility was substantially below the current market rate at the point in time that Charter was prepared to propose its plan of reorganization. Refinancing the pre-petition debt at the then current market rate would have cost Charter approximately $500 million per year in incremental interest charges. In an effort to retain the benefit of the below market interest rates, Charter proposed a plan of reorganization which sought to reinstate the debt owed by Charter to the pre-petition lenders pursuant to Section 1124.

JP Morgan, as agent for the pre-petition lenders, objected to the confirmation of the plan, arguing that its debt could not be reinstated under Section 1124 of the Bankruptcy Code because of certain uncured defaults under the pre-petition credit agreement. In particular, JP Morgan alleged that consummation of the plan would result in a "change of control" default under the JP Morgan credit agreement.

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The plan of reorganization proposed by Charter contemplated that the bonds it had issued pre-petition would be exchanged for equity of the reorganized Charter upon its exit from Chapter 11. JPMorgan took the position that giving the bondholders more than 35% of the equity of Charter constituted a "change of control" under the pre-petition loan documents which was an event of default. And, since such default would not be cured, one of the conditions for reinstatement under Section 1124 could not be satisfied. The term "change in control" was defined in the JP Morgan credit agreement to include the acquisition by any person or *"group"* of the power to vote or direct the voting of more than 35% of the equity interests in Charter.

In considering the arguments of JPMorgan, the Bankruptcy Court took the position that the bondholders did not constitute a "group" for purposes of a change in control under the JP Morgan credit agreement. According to the Bankruptcy Court, the bondholders did not constitute such a group because, even though they acted together and for the same purpose, there was no written agreement among them to do so. Consequently, the Bankruptcy Court held that consummation of the plan did not give rise to a change in control default under the JP Morgan credit agreement. Having found that Charter's proposed plan would not result in a change in control default under the JP Morgan credit agreement, the Bankruptcy Court confirmed Charter's plan of reorganization and thereby permitted Charter to reinstate the $11.8 billion it owed to the pre-petition lenders.

Obviously, a secured lender does not expect to get dragged along providing credit to a company coming out of Chapter 11 on the same terms and conditions that it provided credit to the company previously. The key for the lender in such circumstances lies in the default provisions of its loan documents, since Section 1124 requires that all non-bankruptcy defaults be cured as part of the plan of reorganization in order to reinstate the pre-petition debt. If, for example, it is a default under the loan documents for the borrower to file a plan of reorganization that fails to provide for the repayment in full of the lender, the debtor should be unable to reinstate the debt under Section 1124 of the Bankruptcy Code since it would violate the loan documents.

Of course, it is not always practical to provide in the initial loan documents that it is a default if the borrower files a plan of reorganization that fails to provide for the repayment in full of the lender. However, like waivers of the automatic stay and other bankruptcy provisions, it may be worthwhile to consider including such an event of default in a forbearance agreement or other restructuring agreement. Doing so should help to reduce the risk of a successful reinstatement argument by a debtor under Section 1124 of the Bankruptcy Code.



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