

# **ABI TELECOM PRESS BRIEFING – OUTLINE OF CERTAIN ISSUES ARISING IN TELECOM CHAPTER 11 BANKRUPTCY CASES<sup>1</sup>**

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*Why are the Telecom businesses seeking protection under Chapter 11 of the Bankruptcy Code?*

- Many telecom companies are overleveraged and cannot service their indebtedness.
- Many telecom companies are unable to compete due to their significant debt.
- There is severe price cutting in the industry, and many telecom companies find it nearly impossible to make money while also servicing their debt.
- The financial markets are lending less into the telecom industry making it difficult for the telecom companies to restructure or refinance their indebtedness.
- The telecom industries' technology is constantly changing and improving. Many of the struggling telecom companies are holding onto technologies that will likely be obsolete in the future. Other telecom companies with new technologies are finding it difficult to get funding due to the financial markets' negative view of telecom.

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<sup>1</sup> The views expressed are solely those of the author and should not be attributed to the author's firm or its clients.

## *Why Would a Telecom Company Seek Relief Under Chapter 11 of the Bankruptcy Code?*

- Chapter 11 offers unique relief often needed by a financially troubled company.
- A debtor can reorganize its debts and emerge from Chapter 11 with significantly less debt than before Chapter 11 which may increase its ability to compete in the industry.

### *The Automatic Stay*

- Upon filing Chapter 11, the debtor is afforded “breathing room” due to the imposition of the automatic stay.
- Pursuant to section 362(a) of the Bankruptcy Code, immediately upon commencement of a Chapter 11 case, a stay goes into effect preventing, for example, the commencement or continuation of lawsuits that were or could have been commenced prior to filing the Chapter 11 case, the enforcement of judgments against a debtor or collection of any amounts due to a creditor by the debtor.
- The automatic stay immediately goes into effect when a company files a Chapter 11 petition. There is no need to obtain a court order for such relief.
- There are exceptions to the automatic stay, including an exception allowing the government to continue any actions against a debtor that constitute police or regulatory matters.
- As a result, the government may continue to take actions against a telecom company arguing that their actions are exempt from the automatic stay because they constitute regulatory matters.

### *Financing Options*

- A debtor may be able to obtain financing in Chapter 11 due to additional protections that lenders are given.
- Pursuant to section 364 of the Bankruptcy Code, assuming certain conditions are met, a debtor may be able to obtain financing in a Chapter 11 case that affords a lender first liens against the assets of a debtor even if another lender already holds liens against the same assets.
- As a result, a debtor may be able to access financing that is not available outside of Chapter 11.

### *Sale of Assets*

- Many telecom companies are filing Chapter 11 cases in order to sell their assets.
- Often, a buyer of assets insists that a debtor file a Chapter 11 case and obtain a bankruptcy court order authorizing the sale of the assets to the buyer.
- By obtaining a bankruptcy court order, the buyer will be assured that the assets are sold free and clear of liens, claims, interests and encumbrances and, therefore, the buyer has less risk that it will be liable for the debtor's outstanding debts.
- Pursuant to section 363(b) and (f) of the Bankruptcy Code, a debtor may sell substantially all of its assets free and clear of liens, claims, interests and encumbrances.
- Generally, any creditor holding a lien against the assets to be sold must consent to the sale. However, there are certain exceptions.
- A section 363 sale generally will be subject to higher and better offers.
- The opening bidder (or "stalking horse") generally will be entitled to a break-up fee and bid protections, similar to those protections received outside of Chapter 11.
- A section 363 sale can be conducted outside the context of a plan of reorganization or as part of a plan of reorganization.
- A section 363 sale is a powerful tool to quickly liquidate a debtor's assets and provide value to creditors.
- Generally, in telecom cases, a 363 sale must occur quickly to preserve the value of the debtor's business. Typically, a telecom company has few "hard" assets of value (*e.g.*, real estate, inventory and equipment). Most of the assets being sold are "soft" assets whose value declines quickly (*e.g.*, licenses, receivables and technology).
- 363 sales in telecom cases will often be opposed by the government (who is protecting its licenses) or by companies who have licensed technology to a debtor (who are protecting their technology).
- There are companies buying distressed telecom assets – *e.g.*, cellular phone companies trying to complete their networks, competitors and struggling companies attempting to increase market share.

### *Employee Issues*

- Many telecom companies struggle with maintaining their employee base during Chapter 11.
- The employees often are integral to the company's operations because they understand, maintain and/or developed the technology being sold by the company.
- The debtor must develop incentive plans to encourage the employees to remain with the company through the restructuring or through a 363 sale.
- A buyer may only be interested in purchasing a telecom company's assets if certain key employees agree to sign employment agreements or non-competes with the buyer.

### *Issue Facing a Telecom Company in Chapter 11*

- The telecom industry is heavily regulated.
- Upon filing a Chapter 11 case, a telecom company must be prepared to protect its licenses.
- Currently, in the *Nextwave* case, the Supreme Court is considering the FCC's ability to terminate licenses held by a Chapter 11 debtor post-bankruptcy for failure to pay amounts due.

### *Does Chapter 11 provide an unfair option?*

- No – it is a financial restructuring vehicle. If restructured, the value of the company is given back to the creditors.
- Chapter 11 may increase the restructured company's ability to compete more effectively because it has less debt.
- Chapter 11 permits a company to focus, for example, on marketing issues, not how to pay its creditors.
- If the restructured company does not, for example, have a viable technology, Chapter 11 will not change that fact and the company likely will fail because it is selling a product for which there is no market.