

## Asset Sales in Bankruptcy

### *After the Perfect Storm*

By Douglas P. Bartner  
and Jordan A. Costa

For distressed asset sales, the Great Recession has been something of a perfect storm. The global economic near-catastrophe affected virtually every industry in both the national and global economies, and presented financial market players, corporate CEOs, regulators and government leaders with the horrifying prospect of systemic collapse of the global financial system.

Exacerbating the extreme challenges faced by distressed companies and debtors once in bankruptcy has been an unparalleled contraction in global credit markets. Indeed, at the very same time that bankruptcy filings dramatically increased, the availability of DIP financing dramatically decreased. This has resulted, in part, in an increasing number of asset sales to fund corporate wind downs and reorganizations — including in the high profile bankruptcies of Lehman Brothers, Inc., Chrysler LLC and General Motors Corp. In addition, many debtors able to obtain DIP financing have been required to agree to asset sales on highly compressed timelines as a condition to borrowing.

Along with this increased asset sale activity were the *In re Philadelphia Newspapers, LLC*, 559 F.3d 298 (3d Cir. Mar. 22,

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## Challenges to Reinstatement of Debt under *Young Broadcasting*

By Steven B. Smith and Nicole B. Herther-Spiro

**D**e-acceleration or reinstatement of debt under § 1124(2) of the Bankruptcy Code has long been an option available to debtors. However, to be worthwhile of pursuit, certain conditions must generally exist: namely, a period of easy credit and favorable loans and low interest rates followed by a period of very tight and scarce credit and high interest rates. Under these conditions, a loan agreement containing terms and interest rates much more favorable than present market conditions may be a valuable asset of a debtor that is worth preserving through reinstatement under § 1124(2).

In 2009, as credit markets around the world tightened, these conditions came together, and reinstatement plans returned to the bankruptcy professional's toolkit. Charter Communications, for example, commenced its Chapter 11 cases in March 2009 and sought and obtained, over the objection of various lenders, confirmation of an ambitious plan of reorganization that reinstated \$11.4 billion in secured debt. *See JP Morgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns)*, 419 B.R. 221 (Bankr. S.D.N.Y. 2009). Three months after Charter commenced its Chapter 11 cases, Young Broadcasting commenced its Chapter 11 cases, also in the S.D.N.Y., and proposed a *Charter*-like reinstatement plan. And while both cases focused upon whether the proposed reinstatement would trigger change-in-control provisions in the relevant credit documents, there were facts present in the *Young Broadcasting* case that distinguished it from *Charter*. As a result, the *Young Broadcasting* bankruptcy court sustained the objections of the senior secured lenders and denied the reinstatement plan. *See In re Young Broadcasting, Inc.*, 2010 Bankr. LEXIS 1073 (Bankr. S.D.N.Y. Apr. 19, 2010).

This article explores the facts and circumstances present in both *Charter* and *Young Broadcasting* that led the Bankruptcy Court for the Southern District of New York to reach different conclusions regarding what appeared to be substantially similar reinstatement plans.

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### REINSTATEMENT UNDER THE BANKRUPTCY CODE

Section 1124(2) of the Bankruptcy Code governs the reinstatement of debt and provides that under a plan of reorganization, a debtor may decelerate debt and reinstate the terms of a pre-petition loan agreement that would otherwise be in default. 11 U.S.C. § 1124(2). To reinstate the terms of a pre-petition loan agreement, including the original terms and maturity date, under a plan, the debtor must: 1) cure any pre-petition defaults; 2) compensate the lender for any damages incurred as a result of reasonable reliance on the acceleration of the debt; 3) compensate the lender for any actual pecuniary loss arising from the failure to perform a nonmonetary obligation; and 4) ensure that the plan does “not otherwise alter the legal, equitable, or contractual rights” of the lender. § 1124(2). If the debtor can satisfy these requirements, such claims will be deemed unimpaired under a plan, and upon confirmation, the original terms and maturity of the loan will be reinstated. It will be as though the obligation never went into default.

### THE CHARTER DECISION

In *Charter*, the debtors proposed a plan that sought to reinstate approximately \$11.4 billion of their secured debt. *Charter*, 419 B.R. at 254. Approximately \$1 billion of the debt was maturing or coming due in 2012, another \$2 billion in 2013, and the remainder in 2014. In order to reinstate the secured debt, among other things, the debtors needed to ensure that the plan would not result in a change of control; an incurable non-monetary default under the relevant credit documents. Be-

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cause the credit documents required that Paul Allan, the former principal of Charter, always possess at least 35% of the voting power over Charter's board of directors, but did not require that Mr. Allan hold any percentage of the equity of the company, the debtors incorporated into the plan a settlement with Mr. Allen that provided him with control over the board of directors of the reorganized company. In exchange for his participation in the settlement — which would preserve approximately \$3.5 billion in short and long-term monetary benefits to the company — Mr. Allen would receive approximately \$375 million in cash and equity. *Charter*, 419 B.R. at 253, 253 n.22. Following a vigorously contested confirmation hearing, Judge Peck confirmed the plan.

### THE YOUNG BROADCASTING DECISION

In *Young Broadcasting*, two plans were submitted to the bankruptcy court for consideration; one by the debtors and the other by the official committee of unsecured creditors. *Young Broadcasting*, 2010 Bankr. LEXIS 1073, at \*10-14. The debtors' plan involved an exchange of all of the senior secured debt for equity, resulting in the complete deleveraging of the company. The committee's plan proposed the reinstatement of \$338 million in senior secured debt, which had a maturity date of November 2012, based upon provisions that closely mirrored the *Charter* reinstatement plan. The debtors and the committee decided to seek confirmation of the committee's reinstatement plan, in the first instance. The debtors would seek confirmation of their own plan only if the court denied confirmation of the committee plan. *Id.*

The relevant credit agreements provided that a change in control default would occur if Vincent Young, one of the debtors' founders, and certain members of the Young family (or entities they control), ceased to have control over at least 40% of the board of directors. The agreements also required that if any person or group were to hold more than

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## Young Broadcasting

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30% of the equity, then the Young control group had to own more than 30% of the equity or, alternatively, have the ability to control a majority of the debtors' board of directors. Therefore, to avoid triggering the change in control default, the committee proposed a *Charter*-like settlement that sought to grant Mr. Young all of the Class B stock in the reorganized company, constituting 10% of the equity, which Class B shares would be entitled to cast over 40% of the *number* of votes for the directors of the reorganized company. The remaining equity would be distributed to creditors under the plan. *Id.* at \*20-23.

The senior secured lenders objected to confirmation, arguing, *inter alia*, that: 1) the proposed allocation of voting rights under the committee plan would trigger the change in control default and that any revision to the proposed allocation of voting rights would be a material modification requiring re-solicitation of the plan; 2) the plan was not feasible and the committee's expert, who testified about the debtors' ability to sell or refinance the senior secured debt in 2012, should be disqualified; and 3) the plan failed to meet the cramdown standard, because it violates the absolute priority rule.

### STOCK VOTING PROVISIONS FAIL TO SATISFY CHANGE IN CONTROL COVENANT

The senior secured lenders argued that the new corporate governance provisions in the committee plan would trigger a change in control default under the terms of the relevant credit agreement. *Id.* at \*27-28. In particular, the Young family was required to hold 40% of the "voting stock" of the company, which was defined as capital stock "pursuant to which the holders thereof have the general voting power under ordinary circumstances to elect the board of directors, managers or trustee ... (irrespective of whether or not at the time stock of any other class or classes shall have or might have voting power by reason of the

happening of any contingency)." *Id.* at \*21. While the committee's proposed voting provisions for the reorganized company would give Mr. Young all of the Class B shares, which, by number of shares, would constitute over 40% of the shares of the company, the votes of the Class B shares did not have equal weight as the votes of the Class A shares for the purpose of voting on directors. While holding more than 40% in number of the "voting stock," Mr. Young would only have the ability to appoint one of eight directors of the reorganized company. The committee argued that this arrangement complied with the specific language in the credit documents and would not result in a change of control default, citing *Charter* in support of the proposition that such voting requirements in credit agreements can be manipulated and should be given a narrow interpretation to allow borrowers to engineer solutions that technically conform to their requirements. *Id.* at \*35, 37. The senior secured lenders, on the other hand, argued that the change in control provisions were clearly intended to ensure that Mr. Young have the power to control the election for 40% of the board of directors, and that the committee's proposed voting provisions would result in an immediate default under the credit agreement. *Id.* at \*19, 37.

Applying New York contract interpretation principles to the change of control provisions in the credit agreement, Judge Arthur J. Gonzalez determined that "all of the provisions must be read as part of an integrated agreement and each clause must be intended to have some effect" and therefore concluded that because the purpose of the provisions was to ensure that the Young control group retain 40% of the actual voting power over the members of the board of directors, the committee plan would trigger a change in control default. *Id.* at \*31-38. The court noted that in *Charter*, although the relevant control group only held 10% of the equity, it maintained the requisite 35% of the voting power over management. *Id.* at \*35-36. Judge Gonzalez also

rejected the committee's argument that any modification of the voting provisions would not be a material modification finding that because the proposed modification would alter the corporate governance of the company, it was material, altering the rights of the sole accepting class of creditors that would receive the remaining equity under the plan. *Id.* at 45-46. The court commented that although it might have allowed the committee to re-solicit a revised plan under other circumstances, it would not reach that issue in this case in light of other defects present in the proposed reinstatement plan. *Id.*

### REINSTATEMENT PLAN NOT FEASIBLE

Under section 1129(a)(11) of the Bankruptcy Code, to be confirmed, a plan must not be "likely to be followed by the liquidation or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." 11 U.S.C. § 1129(a)(11). This feasibility requirement puts the burden on the plan proponent to establish that "a plan is workable and has a reasonable likelihood of success." *Young Broadcasting*, 2010 Bankr. LEXIS 1073, at \*68 (quoting *In re World-Com, Inc.*, No. 02-13533, 2003 Bankr. LEXIS 1401, \*168 (Bankr. S.D.N.Y. 2003)). The *Young Broadcasting* bankruptcy court concluded that the "key issue" in determining feasibility of the committee plan was whether it was "reasonably probable" that the senior secured debt could be refinanced in November 2012 when it would come due. *Id.* at \*72. The committee and the senior secured lenders both offered experts on the issue of feasibility. The senior secured lenders objected to the admissibility of the expert testimony of the committee expert, which the court granted in part, excluding the committee expert's testimony as to valuation as lacking sufficient basis, while admitting the committee expert's testimony regarding a potential sale or refinance

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transaction in 2012. *Id.* at 53-67. The court considered the admissible expert testimony of the committee expert and the testimony of the senior secured lenders' expert and proceeded to make its own findings.

Judge Gonzalez first concluded that the committee's projections were not reasonable or reliable. In light of past performance, the projected growth was "aggressive and unrealistic," and the court was "skeptical" about the ability of the debtors "to accurately make business projections and competently execute them as the same management group has historically failed at both tasks." *Id.* at 80-82. In the court's opinion, the debtor had also underestimated corporate expenses and capital expenditures. *Id.* at 83-89. The court identified the key deficiency in the debtors' business plan as follows:

the projected rate of growth in revenue necessarily presumes either a substantial improvement in the industry, increased industry market share within 2.5 years of emerging from bankruptcy, or both . . . . [I]t is unreasonable to project that the Company could achieve substantially higher rate of growth than those of its competitors in an industry that shows no sign of dramatic turnaround within the next 2.5 years.

*Id.* at \*90.

Second, Judge Gonzalez concluded that the committee had failed to establish that there was a reasonable probability of a sale of the company or a refinance of the senior secured debt by November 2012. *Id.* at \*97-98. In fact, the court found that "the prospect of the Company's assumed sale at a price equivalent to its future common equity value in November 2012 is both unsubstantiated and purely speculative." *Id.* at \*93. Likewise, the court found the committee's projections about a possible refinance unreasonable, because they were based on the assumption that excess cash would be

used not to make dividends, but to pay down approximately \$90 million in principal by the maturity date. *Id.* at \*93-98. Accordingly, the court concluded that the committee had failed to meet its burden of establishing that the reinstatement plan was feasible.

Unlike in *Young Broadcasting*, feasibility of the reinstatement plan was not at issue in *Charter*, where the Charter debtors were valued at \$15.4 billion, and there was some evidence that the debtors were worth in excess of \$21 billion in the year prior to their bankruptcy filing. *Charter*, 419 B.R. at 235. The total debt being reinstated in *Charter* was \$11.4 billion, significantly less than the unchallenged value of the company. Moreover, the vast majority of that debt would not come due until 2014, approximately five years after the date of confirmation.

### REINSTATEMENT PLAN VIOLATES THE ABSOLUTE PRIORITY RULE

The senior secured lenders objected to the inclusion within the plan of the settlement with Mr. Young, arguing that its terms violated the absolute priority rule. *Young Broadcasting*, 2010 Bankr. LEXIS 1073, at \*99, 104-05. Under § 1129(b)(2)(B)(ii) of the Bankruptcy Code, for a plan to be "fair and equitable" with respect to a class of unsecured claims, "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B)(ii). For there to be a violation of the absolute priority rule, there must be "a causal relationship between holding the prior claim or interest and receiving or retaining property" under the plan. *Young Broadcasting*, 2010 Bankr. LEXIS 1073, at \*103 (quoting *Bank of Am. Nat'l Trust & Savings Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 424, 451, 119 S. Ct. 1411, 143 L. Ed. 2d 607 (1999)).

Judge Gonzalez ultimately ruled that the committee had failed to meet its burden on this issue, finding that there was "insufficient evidence on the record to evaluate whether the direct and indirect

benefits to the Debtors of reinstating the Credit Agreement are of a greater value than the 10% interest distributed to Young under the Committee Plan." *Id.* at \*106. Judge Gonzalez then distinguished *Young Broadcasting* from *Charter*, where the court specifically found that the \$375 million paid to old equity "was outweighed by an estimated \$3 billion in benefits and savings to the debtor." *Id.* at \*105. In *Young Broadcasting*, the committee simply failed to "quantify the value" of reinstating the credit agreement. *Id.* at \*106.

In light of each of the foregoing reasons, the bankruptcy court denied confirmation of the committee's reinstatement plan and proceeded to confirm the debtors' plan under the cramdown standard of § 1129(b) of the Bankruptcy Code.

### REINSTATEMENT REQUIRES BOTH A COMPELLING LEGAL AND BUSINESS ARGUMENT

Restructuring professionals wishing to formulate a restructuring transaction around a reinstatement plan would be wise to consider all of the issues the Bankruptcy Court for the Southern District of New York considered before approving confirmation of the *Charter* reinstatement plan, on the one hand, and denying the *Young Broadcasting* reinstatement plan, on the other. Indeed, it is critical to remember that a compelling legal argument for the reinstatement of secured debt, alone, is insufficient. A debtor must be able to advance a compelling business argument in support of the proposed reinstatement as well. In particular, a proponent of a reinstatement plan must introduce sufficient evidence to: 1) justify whatever accommodations must be made to old equity to prevent the common change in control default under applicable credit agreements; and 2) establish the feasibility of such a reinstatement plan. In *Young Broadcasting*, it was ultimately not the legal arguments for reinstatement that fell short; it was the inability to make the business case for the reinstatement that led the bankruptcy court to deny confirmation.



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2010) and *Bank of New York Trust Co., NA v. Official Unsecured Creditors' Committee (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009) decisions in the Third and Fifth Circuits, holding that secured creditors do not have the right to credit bid at distressed auctions in certain circumstances.

Notwithstanding the dramatic events of the historic mega-bankruptcies over the last two years and the considerable attention paid to them, little may actually have changed for debtors and potential acquirors of distressed assets on a going-forward basis for at least two reasons: First, the unprecedented nature of, and fear and pains caused by, the near total collapse of western capitalism as we know it may have produced bankruptcy court decisions that, in almost any other market condition, will be of little precedential value. And second, sophisticated secured lenders have already adapted to limit the impact of the two circuit court decisions. As a result, the practice of distressed asset sales may change very little following the Great Recession.

### DIP FINANCING AND SECTION 363 SALES

During the protracted credit crisis, DIP lending has been predominately a defensive exercise undertaken by existing lenders to protect prepetition credit exposure and maintain collateral and enterprise value of debtors. The lenders making defensive DIP loans have sought quick exits and repayment of their DIP and prepetition loans through asset sales. Defensive DIP lenders have increasingly asserted control

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over the bankruptcy process — including by conditioning availability of funds on expeditious section 363 asset sales. These conditions have served to increase the number of section 363 sale transactions during the economic downturn.

### AT THE MARGINS: SUB ROSA PLANS AND BUSINESS JUDGMENT

There are limits on the debtor's ability to sell assets under section 363. A sale that is coupled with the distribution of proceeds to stakeholders could be challenged as a disguised, or “*sub rosa*,” plan of reorganization, which short-circuits the requirements of Chapter 11 for priority, distribution and plan confirmation — and thus steps beyond the margins of section 363.

In addition, while the plain language of section 363 imposes no restrictions on a sale transaction other than “notice and a hearing,” courts have historically required more where the assets being sold constitute all or a substantial part of the debtor's assets. In *Comm. Of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063 (2d Cir. 1983), the Second Circuit held that expediency alone is not sufficient justification for a section 363 sale: Debtors must show an independent business justification as well. While the exigency needn't be that the asset would waste away entirely before it could be sold through a plan of reorganization, something more than appeasing a particular creditor or other constituency is required. In practice, however, the implications of *Lionel* have been rather limited, as bankruptcy courts have readily allowed whole company sales with little of the scrutiny contemplated by the Second Circuit.

### LEHMAN, CHRYSLER AND GM

Recently, there have been several noteworthy uses of section 363 to sell assets in the Lehman Brothers, Inc., Chrysler LLC and General Motors Corp. bankruptcies. Yet while each of these transactions was historic, there is a good argument that, for all of the drama associated with them, the bankruptcies will be of little precedential value.

By way of background, less than one week after Lehman Brothers Inc. filed for Chapter 11, the section 363 sale of Lehman's investment bank to Barclays Capital Inc. was approved. *In re Lehman Brothers Holdings Inc.*, No. 08-13555 (JMP) (Bankr. S.D.N.Y. Sept. 19, 2008). At a contentious sale hearing, certain creditors argued vociferously that the transaction should be delayed, or risk setting a terrible precedent for section 363 fire sales. While noting many of his own concerns with the speed of the sale, Judge James M. Peck approved the transaction. The assets were rapidly declining in value, and the sale “was so exceptional relative to [Judge Peck's] experience ... both as a bankruptcy lawyer and judge” that “it could never be deemed a precedent for future cases” absent “a similar emergency.” And it was “difficult” for Judge Peck “to imagine a similar emergency.”

But similar emergencies soon followed in *In re Chrysler LLC*, 405 B.R. 84, 2009 Bankr. LEXIS 1323 (Bankr. S.D.N.Y., 2009) and *In re General Motors Corp.*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009). Each bankruptcy saw the “good” assets of the struggling automakers divested in rapid-fire section 363 sales arranged prepetition. The transactions included significant and unprecedented prepetition and DIP loans by the United States and Canadian governments. In addition, in exchange for strike, wage and other concessions, the United Auto Workers' retiree health care trust received significant equity stakes in the reorganized entities. Creditors raised numerous objections, including that the sales were impermissibly fast without adequate justification under section 363, and that, by distributing proceeds to creditors outside of a plan of reorganization, the sales constituted *sub rosa* plans. However, relying in part on Judge Peck's decision in *Lehman*, Judge Arthur J. Gonzales, presiding over *Chrysler*, and Judge Robert E. Gerber, presiding over *General Motors*, approved the sales.

Setting aside the complex arguments against the use of section 363

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raised in each case, the precedential value of these decisions may be limited. It seems unlikely that, as Judge Peck posited in *Lehman*, similar exigencies — imploding global economies and financial markets, unprecedented government investment, and immense political pressure — will converge again. Therefore, barring another perfect storm of risk of systemic failure of potential catastrophic national and global financial consequence, the changes to existing law stemming from these cases, if any, may be limited.

### CREDIT BIDDING AFTER PHILADELPHIA NEWSPAPERS

The ability of a secured creditor to credit bid their debt is an important protection against the sale of a secured creditor's collateral for insufficient value. It may also be important to "loan to own" investors as a tool to acquire control over a debtors through the asset sale process. And unsurprisingly, the decisions of the U.S. Courts of Appeals for the Third and Fifth Circuits in *Philadelphia Newspapers, LLC* and *In re Pacific Lumber Co.* restricting credit bidding received a considerable amount of attention. Together, the decisions stand for the proposition that a plan of reorganization may permit the sale of a creditor's collateral under section 1129(b)(2)(A)(iii), without allowing that creditor to credit bid, if the affected creditor receives the "indubitable equivalent" of its claim under the plan.

However, the decisions may have limited impact. First, they have already impacted market practice, with DIP lenders and secured creditors negotiating for DIP and cash collateral orders which require that plan-based asset sales be conducted under section 1129(b)(2)(A)(ii) (which, by its terms, permits credit bidding). And second, the decisions are applicable to plan of reorganization sales only. Section 363 sales are unaffected.

### STRATEGIES AFTER THE PERFECT STORM

As the financial climate continues to improve, recent events, though seismic, may have little effect on most asset sales. Indeed, in recent memory, the bid procedures for a typical section 363 sale have changed very little. Typically, working with investment banking and other financial advisers, debtors will conduct a marketing process to locate potential suitors for assets to be divested. If successful, the marketing process will result in a potential acquiror executing an asset purchase agreement with the debtor. This potential acquiror will act as a "stalking horse," and its "bid" will be shopped by the debtor to other potential acquirers. If no additional suitors emerge, the debtor will close on the sale transaction with the stalking horse. If there is additional interest, the debtor will hold an auction. Should a new bidder top the stalking horse's bid, it will often be required to pay the stalking horse's legal and adviser fees and expenses, as well as a break-up fee.

Yet notwithstanding the limited impact of recent events, debtors can improve the likelihood of a successful asset sale in several ways.

**Focus negotiations with the stalking horse on deal terms, not price.** As bankruptcy auctions tend to focus most often on price, with competing bidders forced largely to accept the stalking horse asset purchase agreement, negotiations with the stalking horse are perhaps the best opportunity to craft favorable deal terms. Carve indemnities back to bare minimum. Remove diligence, financing and other closing conditions. As a corollary, avoid tight milestone deadlines — such as court approval and closing dates — that lead to termination events. Limit deferrals of purchase price and closing escrows.

**Low bid increments may yield the best deal terms.** Minimal incremental bid amounts may engage more potential acquirors in the auction for a longer period of time. Each round of bidding is an opportunity for unsuccessful bidders to

offer more favorable deal terms to the debtor, which the winning bidder will often be forced to accept.

**Build as much time into the process as possible.** Mindful of the exigencies driving the asset sale process, debtors should build as much time into the pre-auction process as is feasible to afford the maximum number of potential acquirors the opportunity to participate. In addition to broadening the competitive pool, allowing bidders an opportunity to conduct a robust diligence inquiry increases the debtor's leverage to negotiate for no diligence closing condition. If a stalking horse bidder is committed with limited termination rights, the risks to the debtor are relatively small in expanding this pre-auction timeline.

**Provide buyers a broad menu of options.** Particularly when auctioning multiple business units or groups of assets, debtors are well advised to consider marketing assets separately, running separate auctions or, at minimum, fashioning bid procedures which allow bids on individual assets or combinations of individual assets. Mindful of the incremental closing risk posted by multiple acquirors, the "highest and best" offer may in fact come from several bidders.

**Negotiate for minimal bid protections.** The stalking horse serves a critical role in many distressed auctions, setting a floor at which assets will be monetized. However, high break-up fees can have a chilling effect on additional bidders expending the necessary resources to participate in a challenge to the stalking horse. In addition, each dollar of break-up fee is ultimately one less dollar received by the debtor.

Similarly, there is room for improvement around the margins for acquirors as well.

**Cash is (often, but not always) king.** The potential buyer willing to offer the greatest amount of cash consideration typically wins the auction. Deal terms are important, but potential acquirors are wise to carefully consider the maximum amount

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# 10 Commandments For a Successful Loan Workout

By Andrew Flame

While we obviously have had our fill of difficult economic news the past few years, all signs point to more challenges ahead. Specifically, there are indications that commercial real estate loans are on increasingly shaky ground. A new study from Real Capital Analytics shows that in the first quarter of 2010 the default rate for commercial mortgages held by banks hit its highest level since in 18 years ... and is expected to keep rising for at least another year. See [www.reuters.com/article/idUSN2426910920100524?type=marketsNews](http://www.reuters.com/article/idUSN2426910920100524?type=marketsNews)

Before long, businesses of all sizes will find themselves having difficult discussions with their lenders regarding loans in default or which will be maturing and for which the real estate and other collateral provide questionable value as security. While businesses obviously need to work diligently to avoid these circumstances, they also need to prepare for the worst. With that in mind, here are 10 commandments for a successful loan workout.

## 10 COMMANDMENTS FOR A SUCCESSFUL LOAN WORKOUT

### **One. Build Credibility**

While every lending relationship is based on trust, when you are in or about to be in default with your bank, trust plays an even greater role in the future of your business' finances. If your lender does not trust you, the process of working out your loan will be greatly extended, more time intensive, and will have less likelihood of success. Building credibility from the first contact with your lender regarding your now "troubled" loan (or even

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better yet, during your entire lending relationship, particularly if your loan officer is the one that handles your workout) will make the process quicker, less adversarial, and less time intensive, and will significantly increase your likelihood of success.

### **Two. Manage Your Lender's Expectations**

Your lender is not going to trust you or believe in your credibility if he/she expects one thing and you deliver something else. Don't try to appease the lender by agreeing to every request when you know you can't fulfill the request. Being truthful up front might be difficult, but it is better than coming up short and harming the trusting relationship with your lender.

### **Three. Meet Deadlines**

If you promise to do something by a certain date, do it. Period.

### **Four. Keep Your Lender Informed**

Keeping your lender informed helps manage the lenders expectations, and build rapport and credibility. If there is a material change in your available cash, projected sales, market conditions or ability to make a promised payment, or there is going to be a delay in getting information to the lender, let your loan officer know. Provide not only good news, but honest news as well.

### **Five. Return Calls**

Nothing (except for misappropriation of funds) destroys a lender relationship and leads to litigation quicker than a borrower that does not return the lender's calls. The lender assumes that the borrower is avoiding him/her and thinks the worst. Return your lenders call promptly. The loan officer is calling because he/she has a question or concern. Even if you cannot answer the lender's questions immediately, returning the call promptly prevents the lender from thinking you are avoiding him.

### **Six. Be Proactive**

Do not wait for your lender to call you if you have something of import, good or bad, to share with him/her. If there is an issue, think

of how it will impact your lender's view of your business and frame a solution or approach that demonstrates to the lender that you are working to correct the situation.

### **Seven. Recognize Your Lender's Goals**

Different lenders may have different goals, but remember that they are running a business too. Their priority could be fees, performing loans, liquidity, etc. — sometimes a lender's goals may be different depending upon internal priorities and what else is happening in their business.

### **Eight. Make Your Loan Officer Look Good**

Thinking like your loan officer and determining what is important to him/her (in contrast to the lender), will assist you suggesting terms that the loan officer will prefer and that will offset other marginal shortfalls from the lender's perspective.

### **Nine. Understand the Difference Between Business Critical, Important, and Just Helpful**

When negotiating with your lender, be sure to be up front about what you need and what you'd like to get in the amended loan documents or forbearance agreement. It is generally more difficult to add terms as negotiations proceed. Know your priorities and be ready to negotiate.

### **Ten. Know Your Own Numbers, Double Check Them, and Then Triple Check Them**

If you provide flawed financial information to your lender, you lose all credibility and the lender then will analyze everything with a fine-tooth comb.

## CONCLUSION

Unfortunately, these rules are very likely going to come into play for far too many businesses over the next couple years. It will be even more unfortunate for those who choose not to follow them.



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## ON THE MOVE

**Grant Thornton LLP** has admitted **Michael Imber** and **Jim Porter** as new principals in its Corporate Advisory & Restructuring Services practice. Imber is based in New York and has recently completed a restructuring of an outdoor media company. He presently represents unsecured creditors in the Forum Health bankruptcy, and is currently serving as New York City Chapter President of the **Turnaround Management Association**. Porter is based in Charlotte, NC, and has a broad range of turnaround experience across a variety of industries, including manufacturing, automotive, retail and health care. He is currently working on the St. Vincent's Catholic Medical Center bankruptcy.

**Lowenstein Sandler PC** announced that **Norman N. Kinel** has joined the firm as a partner in its Bankruptcy, Financial Reorganization & Creditors' Rights Group. He will be

resident in the firm's New York office. Kinel's experience includes representing debtors, creditors, bondholders, trustees and committees of creditors, equity holders and retirees. Most recently, Kinel represented the Official Committee of Unsecured Creditors in the high-profile *Tavern on the Green* case as well as creditors in the *Lehman Brothers* and *Chrysler Corporation* cases. He was formerly a partner at **Duval & Stachenfeld LLP** in New York.

**Jennifer L. Nassiri** has joined **Venable LLP's** Bankruptcy Practice Group in the firm's Los Angeles office. She will serve as of counsel to the firm. This announcement follows the addition of noted bankruptcy attorney **Hamid R. Rafatjoo** in May. Rafatjoo and Nassiri previously worked together at **DLA Piper** and Nassiri came to Venable to work with Rafatjoo again. Nassiri advises

landlords and tenants in bankruptcy and potential bankruptcy situations, and has prosecuted more than 250 fraudulent transfer and preferential transfer actions. She has represented creditors and creditors' committees alike.

**Baker, Donelson, Bearman, Caldwell & Berkowitz, PC** has announced that **Max A. Moseley** has joined the Bankruptcy and Creditors' Rights Group in the firm's Birmingham, AL, office. Moseley was previously with **Johnston Barton Proctor & Rose LLP** from 2004 until 2010, and the New York City office of **Kelly Drye & Warren LLP** prior to 2004. He joins Baker, Donelson as of counsel and his practice focuses on the representation of clients in business reorganization, restructuring, workouts and Chapter 11 bankruptcy proceedings including numerous Official Committees of Unsecured Creditors in complex Chapter 11 Corporate Bankruptcy Proceedings.



### Asset Sales

*continued from page 6*

of cash they are willing to offer. Potential acquirors should also consider their available cash as compared with their competitors: Can additional cash be offered to buy more favorable deal terms than less cash-rich competitors would receive?

**Certainty of closing can be king.** Often the "best" bid is the one which is most certain to close. Presenting a lower risk profile than competitors — particularly by reducing the number of walk-away rights — will often be viewed favorably by the debtor, creditor constituencies and the bankruptcy judge, even though the purchase price may be lower. Potential acquirors should therefore engage legal and financial acquirors in the diligence process as soon as possible. If the stalking horse agreement includes diligence, material adverse change

or other contingencies, can they be deleted or softened? Can letters of credit or other security be posted towards purchase price and closing costs?

**Look carefully at liabilities.** What liabilities are being assumed by the stalking horse? Are there additional liabilities which could be assumed to increase the non-cash component of a bid? This analysis, however, must always be performed in light of the likely recovery scenarios for the estate.

**Non-cash consideration.** Strategic acquirors in particular are often well-advised to consider non-cash consideration — particularly if faced with potentially lower cash availability than their competitors. Can competing bids be topped by offering the debtor shares of the acquiror's common stock?

**Plan for the worst-case scenario.** As financial markets rebound, the pressure to propose asset purchase

agreements with few contingencies will increase. Closing conditions — including diligence, financing and absence of a material adverse change — will become increasingly rare, and will decrease the competitiveness of bids which include such contingencies. However, to avoid buyers' remorse, acquirors should carefully consider the drivers behind their purchase and actively play out crisis scenarios with a view towards the finality of asset purchase agreements prior to bidding.

### CONCLUSION

Much has recently transpired in the world of distressed asset sales. However, going forward, debtors and acquirors are well advised to consider the potentially limited impact of these developments, and thus to sharpen the tools already at their disposal to ensure successful asset sales.



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