



AMERICAN
BANKRUPTCY
INSTITUTE

2018 Winter Leadership Conference

Maximizing Auction Results in a § 363 Sale

Adam G. Landis, Moderator

Landis Rath & Cobb LLP; Wilmington, Del.

Alpesh A. Amin

Conway MacKenzie; Chicago

Jordan A. Kroop

Perkins Coie LLP; Phoenix

John Longmire

Willkie Farr & Gallagher LLP; New York

Leon Szlezinger

Jefferies LLC; New York



ABI Winter Leadership Conference
Panel Discussion
Maximizing Value in 363 Sales
December 7, 2018

Panelists

ABI
Winter Leadership
Conference
2018

Panel Discussion: Maximizing value in 363 sales

- Moderator:
 - Adam Landis, Landis Rath & Cobb LLP
- Panelists:
 - Alpesh Amin, Conway MacKenzie
 - Jordan Kroop, Perkins Coie LLP
 - John Longmire, Willkie Farr & Gallagher LLP
 - Leon Szlezinger, Jeffries & Company

Asset Sale Process Overview

ABI
Winter Leadership
Conference
2018

Advisors must carefully assess the seller's goals, objectives and resources before selecting and implementing any sale strategy

- Every business in distress must evaluate all of its restructuring options, including the sale of part of all of the Company
- Legal and financial advisors with restructuring backgrounds are best suited to guide the Company through all strategic and financial options available to a distressed business
- Once a distressed business and its advisors have chosen a sale path, they must then choose to run the sale process in court or out of court
 - In court options primarily involve chapter 11 bankruptcy, but may also involve judicial foreclosure, receivership or Assignments for the Benefit of Creditors (ABCs)
 - Out of court options include consensual asset or stock sales, Article 9, Strict Foreclosure agreements and other mechanisms
- The best path is the one that maximizes value to all creditors and has the highest likelihood of closing
 - Buyers or potential buyers must be out in the marketplace and want the assets
 - Company must be able to survive the selected sale process
 - Transaction has to have a strong likelihood of closing
 - Without either, the sale process will fail and the Company may be left with no other option but to liquidate its operations

3

Asset Sale Process Overview

ABI
Winter Leadership
Conference
2018

Several factors must be taken into account in determining whether an in-court or out of court process will yield the best overall results for the sale process

- Time required (or available), resources available, creditor composition and disposition, and buyer requirements will all determine the best sale strategy
 - Will the sale proceeds be sufficient to satisfy all of the seller's obligations?
 - Do the assets need to be cleansed from potential creditor claims?
 - What does a buyer require to get comfortable and close?
 - What does the creditor composition look like and will they be impaired?
 - Will the seller survive the Chapter 11 process?
 - Has the Board exercised its Fiduciary Duties in evaluating all of the distressed company's options?
- Chapter 11, itself, is not a solution to a Company's problems and should only be used as part of the Company's overall sale strategy
 - 363 if sufficient value can be realized, if the company can survive the process and if assets need to be transferred free and clear
 - If not, other options, both in court and out of court, may be available such as private sale, Article 9, Assignment for the Benefit of Creditors (ABC), Foreclosure, Receivership or Chapter 7 liquidation
 - Seller must work carefully with experienced advisors in order to evaluate all options and determine the best path to maximize value for all creditors

4

Turnaround Advisors' Perspective

ABI
Winter Leadership
Conference
2018

Turnaround professionals have deep restructuring experience and when engaged, help to maximize a distressed company's chance of survival and maximum value recovery for all creditors

- Boards and Management teams benefit from turnaround advisors' unbiased restructuring lens, as the advisor provides:
 - Assessment of financial and operational state of the business
 - Accurate financials and projections
 - Analysis of all available restructuring options and formulation of the most appropriate restructuring plan
 - Insurance for the Board – advisors aid in ensuring Directors fulfil their fiduciary duties (duty of loyalty, duty of care) as they enter the “zone of insolvency”
 - Experience in negotiating with secured and unsecured creditors
 - Ability to retain control of restructuring and provide credibility to stakeholders
- During a distressed sale process, turnaround professionals are critical in maximizing value and ensuring certainty of close
 - Restructuring options evaporate and asset values decline with time as distress progresses without intervention - early contingency planning and quick action aided by advisors is the best path to maximize value
 - Aid in preparation of marketing materials, due diligence and closing
 - Help buyer and seller focus on value above what is achievable in liquidation - historical financial and operational results may not be indicative of future results under better capitalized ownership
 - Promote speed in diligence and APA negotiations, which are critical when dealing with a distressed sale
 - Assist management team in presenting strengths and addressing weaknesses to buyers
 - Communicate with all stakeholders to keep them informed and from taking legal action that may be available
 - Keep the business alive and operating during the sale process

5

Restructuring Counsels' Perspective

ABI
Winter Leadership
Conference
2018

Considerations Impacting Whether to Sell In Court or Out of Court

- In Court (Section 363) Process
 - Provides the buyer with certainty that it will not have exposure to liabilities of the seller unless they are expressly assumed (with limited exceptions in the environmental and products liability areas) through a “free and clear” sale order
 - Protects the seller and its Board against fraudulent conveyance and other litigation risks related to the sale, as the Court will approve the sale only if it finds that the sale process was sufficiently robust and yielded the highest or best available offer.
 - Allows the seller to “cherry pick” contracts and other assets, and to override obstacles such as consent-to-assignment provisions in leases and other agreements
 - Can provide “stalking horse” protections, such as a break-up fee and expense reimbursement, in the event of an overbid
- Out of Court
 - Can be completed much more rapidly and less expensively than a 363 Sale
 - Avoids risks of litigation from groups such as Creditors' Committees, who may be motivated to object to a sale in order to extract value from senior creditors
 - Does not eliminate risks of future litigation, on theories such as successor liability, fraudulent conveyance or breach of fiduciary duty

6

Distressed vs. Non-Distressed Sale

ABI
Winter Leadership
Conference
2018

How distressed M&A sale transactions differ from non-distressed M&A sale transactions

It's important to understand how non-distressed M&A differs from distressed M&A when assessing sale options. Distressed transactions typically have more risk in execution than non-distressed transactions. Fortunately, several options exist for distressed assets to be bought and sold. Below are some key differences between non-distressed and distressed M&A transactions.

Non-Distressed M&A

- Owner "wants" to sell
- Purchase price sufficient to relieve all seller obligations
- Valuations are market-multiple based
- Can be asset or stock sales
- Longer sale process timeline - 9 to 12 months
- Extensive due diligence periods
- Adequate representations and warranties that survive closing
- Indemnity and escrows
- Surviving seller is the target for breach lawsuit or seller parent may guarantee
- Small constituent base: seller, seller's management team, seller's equity

Distressed M&A

- Owner "has" to sell
- Purchase price most likely insufficient to relieve all seller obligations
- Valuation floor is typically liquidation value
- Almost always asset sales
- Expedited sale process timeline - 3 to 4 months
- Short due diligence periods
- Seller may not remain post close to provide reps and warranties
- Successor liability issues may arise
- May require interim funding during sale process
- Larger constituent base: seller, seller's management team, seller's equity AND secured lenders, suppliers, landlords, customers, employees...

7

In Court vs. Out of Court

ABI
Winter Leadership
Conference
2018

Types of Sales in Restructurings

If a distressed sale process is chosen as the best restructuring option, Seller and its Advisors must consider whether an In Court or Out of Court sale process will be best suited in order to maximize value to all creditors. Below are various types of M&A sale processes that can be utilized in a Company's restructuring, involving a sale of part of or all of its assets.

Out of Court

- Non judicial, consensual process
- May require the cooperation/participation of the seller's lenders, suppliers and other stakeholders
- Must determine if out of court path is more favorable than outcome in a judicial process
- Can be a private sale or a public auction
- Traditional sale
- Article 9 (Secured Party Sale)
- Foreclosure / Deed of Trust

In Court

- Judicial, court oversight processes
- Assignment for Benefit of Creditors (ABC)
- Receivership
- Chapter 11 - Section 363 sale
- Sale pursuant to a Chapter 11 plan
- Chapter 7 liquidation

8

Typical Distressed M&A Sale Paths

ABI
Winter Leadership
Conference
2018

<i>Out of Court Sale</i>	<i>Chapter 11 Section 363 Sale</i>	<i>Other In Court Options</i>
<p>Non judicial, consensual process that is pursued out of court similar to a non-distressed sale but on an expedited basis:</p> <ul style="list-style-type: none"> ▪ Limited risk of disruption of the seller's business ▪ Transaction costs lower than in court processes ▪ Time to closure is usually quickest ▪ Difficult to bind creditor groups ▪ Buyers may be concerned about subsequent fraudulent transfer or successor liability ▪ Potential unstable environment with a risk of involuntary filing ▪ May require a Chapter 11 process to consummate 	<p>Sale process can start out of Chapter 11 with a filing timed with a Stalking Horse Bid and APA:</p> <ul style="list-style-type: none"> ▪ Heightened risk of disruption to the seller's business ▪ Higher transaction costs ▪ Lengthiest sale process timeline as multiple constituencies and court process required ▪ Binds creditors ▪ Free and clear of all liens and liabilities ▪ Minimum fraudulent transfer / successor liability risks ▪ Contract assumption/rejection opportunities ▪ Stable auction environment without the risk of an involuntary filing ▪ Break up fees and expense reimbursement for Stalking Horse 	<p>Other in court options that may be pursued include Assignments for the Benefit of Creditors and Receiverships:</p> <ul style="list-style-type: none"> ▪ Limited risk of disruption of the seller's business ▪ Transaction costs lower than Chapter 11 ▪ Shorter sale process timeline than Chapter 11 363 sale ▪ Some ability to bind creditors ▪ Might be viewed as risky by inexperienced buyers ▪ Buyers may be concerned about subsequent fraudulent transfer or successor liability ▪ Potential unstable environment with a risk of involuntary filing

9

Why a 363 Sale Maximizes Value

ABI
Winter Leadership
Conference
2018

Key Benefits of Section 363 Sale in Chapter 11

- **Free and Clear** – Court order approved sale typically includes language approving the sale “free and clear” of all liens, encumbrances, etc. giving a buyer great comfort. Buyers may assume certain liabilities as it sees fit. Trade creditors, suppliers, and employees can all be treated differently in the 363 sale, providing the buyer with flexibility
- **Sale Process** – Debtor runs a court approved sale/marketing process after a notice and hearing. If debtor runs sale in accordance with the approved process, its board of directors should be protected as they carried out their fiduciary duties. Further, an auction may allow for higher and better competing bids – thus driving additional value
- **Finality** – Sale requires court approval and other than any appeals, sale will not be subject to further litigation or unwinding. Sale is memorialized by court order
- **Ability to bind creditors and constituencies** – Shareholder approval for sale not required in bankruptcy, and Chapter 11 363 sale also gives debtor right to sell assets despite contractual anti-bankruptcy provisions and similar sale restrictions
- **Freedom to Assume / Reject Executory Contracts** – Seller can reject contracts and buyer can assume contracts providing a great deal of flexibility. Further, change of control provisions in executory contracts will not apply
- **“As Is Where Is”** – No indemnities for breaches of representations and warranties in a 363 sale – buyer must conduct due diligence or suffer consequences – although “hold backs” are common and may be used

10

Considerations In Choosing 363 Sale

ABI
Winter Leadership
Conference
2018

Chapter 11 - 363 Sale Pros and Cons

Careful planning and coordination with experienced advisors is key when pursuing a 363 sale option in Chapter 11. Buyers will almost always prefer the protections and flexibility afforded when purchasing distressed assets through a section 363 sale process. However, the seller and its advisors must determine if the Company can afford the costs and survive the process.

Pros

- Distressed value pricing
- Ability to cherry pick assets
- Free and Clear of Liens and Interests
- Insulation from Fraudulent Transfer
- No need for counterparty consent to assignment of most contracts and leases
- No need for target shareholder approval

Cons

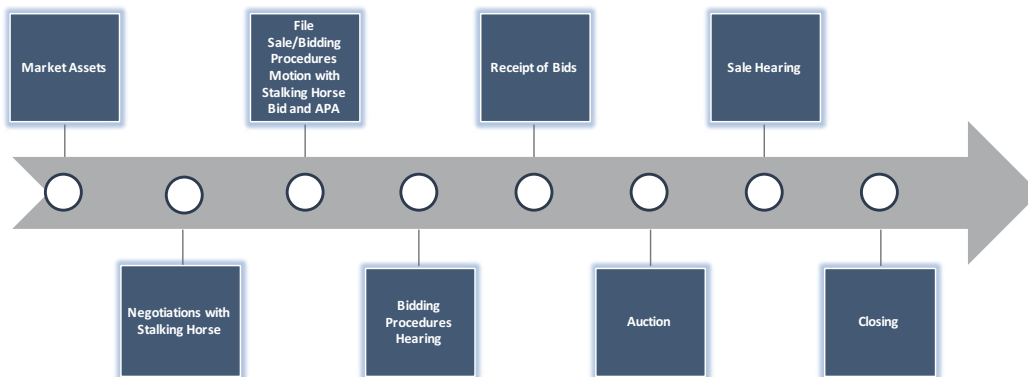
- Longer timeline and more costly
- Subject to auction
- Potential negative effects of Chapter 11 on seller's business
- Time and uncertainty due to need for court approval
- Multiple negotiations with debtor and committees

11

Typical 363 Sale Timeline

ABI
Winter Leadership
Conference
2018

Major events in a typical 363 sale timeline are depicted below



- Approximately 90 – 120 day timeline
- Marketing of assets and negotiations with buyers can begin before filing for Chapter 11 or inside Chapter 11

12

Legal Perspectives on Insider/Secured Creditor Bid Protections

ABI
Winter Leadership
Conference
2018

- Delaware Courts routinely approve break up fees and expense reimbursements in favor of 3rd party stalking horse bidders using an “administrative claim” standard under section 503(b)(1)(A) of the Bankruptcy Code, after a showing that the bidder provided an **actual benefit to or preserved the value of** the estate
Calpine Corp. v O’Brien Envtl. Energy, Inc. (In re O’Brien Envtl. Energy, Inc.), 181 F.3d 527 (3d Cir. 1999); *In re Reliant Energy Channelview, LP*, 594 F.3d 200 (Bankr. D. Del. 2009).
- Evidence that the stalking horse bidder **required** the bid protections to **induce the bid** and/or that **the bid will provide a floor** against which other bidders will compete is sufficient to satisfy the “administrative claim” standard. *See, e.g., In re NEC Holdings Corp.*, 2010 Bankr. LEXIS 5959, *5 -*6 (Bankr. D. Del. 2010).
- Bid protections must balance the debtor’s **duty** to maximize value for all stakeholders with the stalking horse bidder’s **desire** to purchase assets at the lowest price and least amount of competition. *See generally In re Taylor-Wharton Int’l, LLC*, 2010 Bankr. LEXIS 3268 (Bankr. D. Del. 2010) (*Bankruptcy Court approves bid protections by evaluating the duties and best interests of all parties*).

13

Legal Perspectives on Insider/Secured Creditor Bid Protections

ABI
Winter Leadership
Conference
2018

- Additional tensions arise when a stalking horse bidder is an **Insider or Secured Creditor**
 - Insider and Secured Creditors start with **inherent advantages** over 3rd party bidders
 - Insiders have **access to information** and **historical knowledge** about the target/debtor enterprise
 - Secured Creditors have an **informational advantage** by virtue of prior due diligence and are bidding claims pursuant and subject to section 363(k) of the Bankruptcy Code, not cash
- As bidders, insiders and secured creditors can use their inherent advantages to try to obtain the **lowest purchase price and chill bidding**. *See generally United States v. State St. Bank & Trust Co.*, 520 B.R. 29 (Bankr. D. Del. 2014).
- This is in conflict with a debtor’s duty to maximize value of assets on behalf of all stakeholders.

14

Legal Perspectives on Insider/Secured Creditor Bid Protections

ABI
Winter Leadership
Conference
2018

- Bid Protections in favor of Insiders and Secured Lenders are Increasingly Difficult to Obtain in Delaware
 - There have been ***no reported decisions*** in Delaware setting forth the standard for approval of bid protections in favor of Insider and Secured Lender stalking horse bidders
 - Upon appropriate satisfaction of the *O'Brien*/Administrative Claim standard, the trend appears to be moving to ***permit reimbursement of actual, reasonable, documented expenses*** upon an appropriate trigger event (*i.e.*, the closing of an alternative transaction) and ***deny break up fees*** for stalking horses that are insiders and/or secured lenders. *See, e.g., In re Halt Medical, Inc.*, Chapter 11 Case No. 17-10810 (Bankr. D. Del. May 4, 2017) (LSS); *In re Peekay Acquisition, LLC*, Chapter 11 Case No. 17-11722 (Bankr. D. Del. Sept. 7, 2017) (BLS); *In re Jumio Inc.*, Chapter 11 Case No. 16-10682 (BLS)

15

Break-Up Fees

ABI
Winter Leadership
Conference
2018

- A stalking horse buyer's entitlement to a break-up fee is not a foregone conclusion, at least in some courts
- Although a (large?) majority of courts will pre-approve an appropriately-sized break-up fee at the outset of the shopping period in a 363 sale context—except for insider or loan-to-own stalking horses—there is a notable trend of hostility to break-up fees fundamentally and conceptually in some courts
- Most cogent argument against break-up fees in 363 sales is still that articulated by former Bankruptcy Judge Bruce Markell—*The Case Against Breakup Fees in Bankruptcy*, 66 Am. Bankr. L.J. 349 (1992)
 - Some judges still adhere to these arguments and refuse to approve break-up fees in all cases
 - *In re America West Airlines, Inc.*, 166 B.R. 908 (Bankr. D. Ariz. 1994) (general hostility toward break-up fees except in extraordinary circumstances; rejected business judgment rule standard)
 - *In re S.N.A. Nut Co.*, 186 B.R. 98 (Bankr. N.D. Ill. 1995) (even stronger hostility, based on Markell article)

16

Break-Up Fees (cont.)

ABI
Winter Leadership
Conference
2018

- Argument against break-up fees in bankruptcy cases summarized:
 - The debtor can obviate the need for a break-up fee by increasing the information available about the assets being sold to “standardize” publicly-available information
 - This makes the market for the assets more “efficient” in that more bidders are exposed to more, better information without having to rely on the stalking horse and without exposing the stalking horse to the “free rider” problem of having other bidders rely on the stalking horse’s investment in due diligence
 - Bankruptcy Code sec. 363 focuses far more on substance of the sale rather than procedure, which tends to be the focus of non-bankruptcy sale processes—in this way, the economic implications of a break-up fee are far more important to the necessary inquiry of a 363 sale than a non-bankruptcy M&A sale context
 - A break-up fee cannot act as liquidated damages for the stalking horse in a 363 sale context because a sale contract isn’t enforceable unless and until it is approved by the court
 - Break-up fees should not compensate the stalking horse for its due diligence because bidders can “adjust their bids” to compensate for the cost of due diligence
 - Typically due diligence costs are borne by the eventual stalking horse long before it actually becomes the stalking horse, such that the stalking horse would have incurred those costs anyway, since there was no guaranty of being selected as a stalking horse

17

363 Sale Comparison (Announced 1/1/17 – 10/5/18)

ABI
Winter Leadership
Conference
2018

Select Comparison of Key Terms (\$Millions)

Debtor	Filing Date	Stalking Horse Party	Credit Bid?	Stalking Horse Bid	Initial Topping Bid	Subsequent Overbids	Subsequent Overbid (% of Bid)	Break-Up Fee	Break-Up Fee (% of Bid)	Expense Reimbursement	Expense Reimbursement (% of Bid)	Required Cash Deposit (% of Bid)
Aralez Pharma (Mimov)	8/10/18	Nuvo Pharmaceuticals Inc.	No	48	2.6	0.5	1.1%	1.66	3.5%	0.43	0.9%	4.0%
Aralez Pharma (Toprol) ⁽¹⁾	8/10/18	Deerfield Mgmt Co. LP (Secured Lender)	Yes	130	1.0	1.0	0.8%	None	N/A	0.50	0.4%	4.0%
Aralez Pharma (Canadian Assets)	8/10/18	Nuvo Pharmaceuticals Inc.	No	63	3.3	0.5	0.8%	2.19	3.5%	0.58	0.9%	4.0%
Rockport Co. LLC	5/14/18	Charlesbank Capital Partners LLC	No	150	0.5	0.3	0.2%	4.50	3.0%	2.00	1.3%	10.0%
Nine West Holdings Inc.	4/6/18	Authentic Brands Group LLC	No	200	1.0	1.0	0.5%	6.00	3.0%	0.75	0.4%	10.0%
FirstEnergy Solutions Corp.	3/31/18	Exelon Corp.	No	140	1.0	1.0	0.7%	4.20	3.0%	1.40	1.0%	10.0%
Weinstein Co. Holdings LLC	3/19/18	Lantern Capital Partners LP	No	310	1.0	1.0	0.3%	9.30	3.0%	6.20	2.0%	5.0%
4 West Holdings Inc.	3/6/18	SC-GA 2018 Partners LLC	No	225	1.0	1.0	0.4%	4.00	1.8%	0.50	0.2%	1.8%
Real Industry Inc.	11/17/17	Ad Hoc Noteholder Group	Yes	364	1.0	1.0	0.3%	None	N/A	None	N/A	7.5%
Appvion Inc.	10/1/17	DIP Lenders	Yes	325	0.5	0.5	0.2%	4.88	1.5%	0.50	0.2%	2.7%
Angelica Corp.	4/3/17	KKR (Prepetition Term Loan Lender)	Yes	125	1.0	1.0	0.8%	None	N/A	0.75	0.6%	10.0%
Azure Midstream Partners LP	1/30/17	Enterprise Products Operating LLC	No	151	1.0	0.5	0.3%	4.53	3.0%	1.00	0.7%	10.0%
Avaya Inc. (Networking Business)	1/19/17	Extreme Networks Inc.	No	100	1.0	1.0	1.0%	3.00	3.0%	0.75	0.8%	10.0%
Max							1.1%	\$ 9.30	3.5%	\$ 6.20	2.0%	10.0%
Average							0.6%	4.43	2.8%	1.28	0.8%	6.8%
Median							0.5%	4.35	3.0%	0.75	0.7%	7.5%
Min							0.2%	1.66	1.5%	0.43	0.2%	1.8%

(1) No deposit required for credit bid.

18