Modern-Day 363 Sale Best Practices

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A. Agent for Lenders

Pursuant to Section 363(f)(2) of the Bankruptcy Code, “assets sold pursuant to § 363(b) may be sold ‘free and clear of any interest’ in the assets when, inter alia, the entity holding the interest consents to the sale. 11 U.S.C. § 363(f)(2). Indiana State Police Pension Trust v. Chrysler, LLC (In re Chrysler LLC), 576 F.3d 108, 120 (2d Cir. 2009), vacated with instructions to dismiss as moot, 558 U.S. 1087, on remand, 592 F.3d 370 (2d Cir. 2010) (vacating judgment and dismissing appeal as moot). Loan agreements often appoint a collateral and administrative agent and authorize the agent to exercise all rights afforded to a secured party under the Uniform Commercial Code or other applicable law and to sell or otherwise dispose of the collateral. One such right that a secured party may exercise is the right to credit bid for its collateral under Section 363(k) of the Bankruptcy Code. “When dealing with such lending arrangements, the purpose of contracting in advance to restrict enforcement to a single agent is to prevent the chaos that would ensue if multiple lawsuits were initiated by each lending bank with, possibly, divergent interests.” In re Enron Corp., 302 B.R. 463, 472-73 (Bankr. S.D.N.Y. 2003) (citing Credit Francais Int’l S.A. v. Sociedad Financiera de Comercio, C.A., 128 Misc.2d 564, 581-82, 490 N.Y.S.2d 670, 682 (N.Y. Sup. Ct. 1985)). Providing such authority to a single agent also “prevents a single lender from being preferred over others.” Id. at 473.

In Chrysler, certain lenders did not consent to the release of their collateral in a sale under Section 363. The bankruptcy court, however, concluded that “consent was validly provided by the collateral trustee, who had authority to act on behalf of all first-lien credit holders.” 576 F.3d at 119. The Second Circuit agreed, reasoning that “[t]hrough a series of agreements, the Pensioners effectively ceded to an agent the power to consent to such a sale; the agent gave consent; and the Pensioners are bound.” Id. Specifically, the first-lien holders, including the Indiana Pensioners, arranged their investment in Chrysler by means of three related agreements: a first-lien credit agreement, a collateral trust agreement, and a security agreement. Id. Together, those agreements “create[d] a framework for the control of collateral property,” which was held by a designated trustee or the benefit of the various lenders. Id. at 119-120. In the event of a bankruptcy, the trustee was “empowered to take any action deemed necessary to protect, preserve, or realize upon the collateral.” Id. at 120. “The trustee may only exercise this power at the direction of the lenders’ agent; but the lenders are required to authorize the agent to act on their behalf, and any action the agent takes at the request of lenders holding a majority of Chrysler’s debt is binding on all lenders, those who agree and those who do not.” Id. Thus, the Second Circuit held that:
“[w]hen Chrysler went into bankruptcy, the trustee had power to take any action necessary to realize upon the collateral — including giving consent to the sale of the collateral free and clear of all interests under § 363. The trustee could take such action only at the direction of the lenders’ agent, and the agent could only direct the trustee at the request of lenders holding a majority of Chrysler’s debt. But if those conditions were met — as they were here — then under the terms of the various agreements, the minority lenders could not object to the trustee’s actions since they had given their authorization in the first place.”

Id.

In *In re GWLS Holdings, Inc.*, Case No. 8-12430(PJW), 2009 WL 453110 (Bankr. D. Del. Feb. 23, 2009), the court held that a security agreement authorized an agent to credit bid over the objection of a dissenting secured creditor. In *GWLS*, the debtors sought to sell substantially all of their assets to a group of lenders whose $337 million in debt was secured by first liens on substantially all of the debtors’ assets. A first-lien lender holding $1 million of the secured debt objected to the sale.

The *GWLS* court noted that the credit agreement authorized the agent to “exercise such powers as are delegated to such Agents by the terms hereof and thereof together with such actions as are reasonably incidental thereto.” *Id.* at *5*. The *GWLS* court also noted that the collateral agreement executed contemporaneously with the credit agreement provided the agent with the right to “dispose of or deliver the Collateral or any part thereof” and that the agent thereunder was given “all rights and remedies of a secured party under New York UCC or any applicable law.” *Id.* at *5*. Based on those provisions, the *GWLS* court held that the agent was authorized by “the clear and unambiguous language” of the agreements to credit bid for its collateral. *Id.* at *6*. See also *In re GSC, Inc.*, 453 B.R. 132, 172 (Bankr. S.D.N.Y. 2011) (“When the Non-Controlling Lenders entered into the Prepetition Credit Agreement and Security Agreement, they agreed that the Agent had the sole ability to take action on the Collateral and realize upon the security.”); *In re Foamex Internat’l Inc.*, Case No. 09-10560 (KJC) (Bankr. D. Del. May 26, 2009) (holding that, under the loan documents and at the direction of a majority of secured lenders, the collateral agent could credit bid and thereby “drag along” the dissenting bidders).

The Second Circuit in *Chrysler* and the bankruptcy court in *GWLS* rejected the argument that unanimous consent of all lenders was required because the agent’s authority to credit bid did not involve any amendment or modification of the loan documents. *See Chrysler*, 576 F.3d at 120 (“Because the Sale required no amendment to the loan documents, Chrysler was not required to seek, let alone receive, the Pensioners’ written consent.”); *GWLS*, 2009 WL 453110 at *6; see also *Beal Sav. Bank v. Sommer*, 865 N.E.2d 1210, 1217-18 (N.Y. 2007) (concluding that provisions in a syndicate loan arrangement requiring unanimous consent by participating lenders in order to amend, modify or waive terms of related loan agreements did not preclude application of specific provisions which accomplished the parties’ agreed-upon intent for collective action through an agent upon default by borrower).
In *In re Metaldyne Corp.*, 409 B.R. 671, 678 (Bankr. S.D.N.Y. 2009), aff’d in part and appeal dismissed in part as moot, *BDC Fin., L.L.C. v. Metaldyne Corp.*, 421 B.R. 620 (S.D.N.Y. 2009), the bankruptcy court also approved a Section 363 sale over the objection of a dissenting lender where the agent consented to the sale. The court declared that the lender’s desire not to participate in the sale did not change the fact that the agent was authorized to act on the lender’s behalf. *See In re Metaldyne Corp.*, 409 B.R. at 675 (“what BDC is complaining about is fundamentally a dispute with the Agent, the Lenders, and MDI, not with the credit bid itself.”); *see also In re GSC, Inc.*, 453 B.R. 132, 173 (Bankr. S.D.N.Y. 2011) (“The Non-Controlling Lenders’ complaint constitutes a dispute between the Agent, the Prepetition Term Lenders, and Black Diamond Capital Management, not with the credit bid itself.”). The court further declared that the fact that dissenting lenders “do not like the outcome is not a basis to ignore the governance provisions of the relevant agreements.” *See Chrysler*, 405 B.R. at 103.

Moreover, if the agent credit bids the full amount of the lenders’ claim, the credit bid satisfies or extinguishes the entire amount due under the loan agreement. *See McInerney v. Tang*, 5 F.3d 537 (Table), 1993 WL 312763, at *2 (9th Cir. Aug. 18, 1993) (“[T]he Pecks Lane Property had been sold in exchange for a full credit bid. This extinguished the debt of the McInerneys to the Goodman defendants.”). Thus, as a result of the Agent’s credit bid, BDC has no claim. *See In re Spillman Dev. Group, Ltd.*, 401 B.R. 240, 256 (Bankr. W.D.Tex. 2009) (“Because Fire Eagle’s $9.3 million credit bid satisfied the underlying debt secured by the SIG CD, Fire Eagle does not have a valid claim to the SIG CD.”); *In re Ocean Blue Leasehold Prop. LLC*, 414 B.R. 798, 807 (Bankr. S.D.Fla. 2009) (“Legg Mason’s claim was extinguished when it credit bid the full value of its claim in connection with its acquisition of the Property from the Chapter 11 Trustee”). Thus, after a credit bid, a dissenting lender is no longer entitled to adequate protection because it has no secured claim. *See In re Metaldyne Corp.*, 409 B.R. at 679 n.11 (noting that the loan agreement assigned the agent the right to demand adequate protection and declaring that “BDC may have been a secured creditor at the outset, but once the Agent, acting on the secured lenders’ behalf, releases the liens, BDC loses its status as a secured creditor entitled to adequate protection under § 363(e).”).

A dissenting lender, however, may retain a claim against the consenting lenders or the agent. *See In re GSC*, 453 B.R. at 172 (“Although the Security Agreement also provides that the Agent must act for the benefit of the secured creditors, the parties agreed that the remedy for a violation of this provision would be a complaint in State Court.”); 1 *Foamex Internat’l*, Case No. 09-10560 (reserving the dissenting lender’s right to bring claims and causes of action relating to their entitlement to a larger pro rata share of the sale proceeds).

The fallout that may confront an agent and consenting lenders when credit bidding without the support of all lenders is demonstrated in the unreported decision of *Prudential Ins. Co. of Am. v. WestLB AG*, 37 Misc.3d 1208(A), 961 N.Y.S.2d 360 (Table), 2012 WL 4854713 (N.Y. Sup. Ct. Oct. 12, 2012). Although the lenders preferred a third-party sale, they were concerned that the credit crisis would result in unsold collateral or a recovery of pennies on the dollar. *Id.* at *1. Thus, the agent, with the support of required lenders (i.e., a majority),

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successfully credit bid for certain of the debtor’s assets. *Id.* Pursuant to the asset purchase agreement, the purchased collateral would be transferred to limited liability companies created by the agent. *Id.*

Some, but not all lenders, had extended DIP financing and exit financing. *Id.* at *2.* When the agent drafted the operating agreements for the purchaser entities, the agent “sought to create a management and ownership structure that rewarded the exit lenders through ‘participation enhancements’ over those lenders who initially refused to commit funding.” *Id.* Specifically, the lenders that participated in the exit financing, Class A members, were to receive “priority in distribution,” “superior voting rights,” shares of $45 million in combined “liquidation preferences” and favorable conversion rights. *Id.* at *2-3.*

In contrast, lenders that signed the operating agreement but did not participate in the exit financing, Class B members, were to have inferior voting rights. *Id.* at *3.* In addition, the plaintiffs and other lenders that did not participate in the exit facility or sign the operating agreement (i) had no voting rights, (ii) were excluded from participating in management, and (iii) would not receive financial statements for the limited liability companies. *Id.*

After the credit bid, a third party purchased the lenders’ collateral for $200 million. *Id.* The dissenting plaintiff-lenders sued the agent and other lenders in New York state court, asserting, *inter alia,* claims for breach of contract and conversion. *Id.* The plaintiff lenders contended that they were entitled to a pro rata distribution of sale proceeds under the loan agreements. *Id.* at *4.* The agent argued that the disparate treatment was “necessary and desirable” to “protect or realize upon” the collateral because enhancements for the exit lenders were necessary to incentivize them to provide the exit financing without which the collateral would have sold for much less. *Id.*

Rejecting the agent’s argument, the New York court held that several provisions of the loan documents (a) contained “mandatory” language as to ratable distribution amongst the lenders, which could not be modified without the unanimous consent of all lenders, and (b) precluded the agent from releasing the lenders’ collateral without unanimous consent. *Id.* at *4-5.* Thus, there was “no legal justification for [the agent’s] contention that the exit lenders deserve more than other lenders in the proceeds from the [sale] transaction.” *Id.* at *5.* Thus, the court concluded that the exit financing lenders were liable for conversion because they “accepted the plants, the distribution of membership interests therein, and the cash proceeds from its sale in complete disregard to plaintiffs’ ownership interests.” *Id.* at *7.* See generally Lisa Bittle Tancredi, *Has Collective Design Reached Its High-Water Mark?*, Am. Bankr. Inst. J., March 2013, at 32 (discussing *WestLB*).

In a further effort to avoid liability, the agent sought protection under an exculpation clause in the loan documents. The court determined that there was a triable issue regarding the agent’s potential liability for breach of contract. *Id.* at *6.* The court dismissed the conversion claim against the agent as duplicative of the breach of contract claim. *Id.* at *7.*
B. Indenture Trustee

In *In re Electroglas, Inc.*, No. 09-12416 (PJW) (Bankr. D. Del. 2009), a majority and minority group of secured noteholders sought to credit bid for the debtor’s assets. Neither group of noteholders issued its credit bid through the indenture trustee.

The bankruptcy court rejected both credit bids because the prepetition credit documents gave the indenture trustee the exclusive right to exercise remedies and provided that the lenders could only request (rather than direct) that the indenture trustee take certain actions. Therefore, the court held that only the indenture trustee had the ability to credit bid.
The recent difficulties with the sale process in the chapter 11 bankruptcy case of *Revel AC, Inc.* (Bankr. D.N.J., No. 14-22654), may lead one to ask, “When is the sale process over?” In *Revel,* however, the reasons for the prolonged sale process were quite unusual. The initial successful bidder decided not to close and to forfeit its deposit. A second successful bidder (the “backup bidder”) objected to court approval of its own bid. After the bankruptcy court indicated that the second bidder would forfeit its deposit, the second bidder negotiated a new sales contract with *Revel.* By that time, another potential purchaser (represented by the author) demonstrated the financial wherewithal to close the sale of the casino and sought a short period of time to negotiate with other parties (such as the power provider) in order to formulate a bid. Although the court provided a short period of time, the negotiations, they were unsuccessful. Before approval of the second bidder’s revised sales contract, yet another potential bidder emerged and requested another auction. At that time, the court refused to order another auction and approved the sale to the second successful bidder. See Michael Bathon, *Revel Wins Court Approval to Sell Casino For $82 Million to Polo North on Fourth Try,* Mergers & Acquisitions Law Report (BNA) (April 2015).

Generally, the purpose of a bankruptcy sale is to obtain the highest and best price for the estate and thus for its creditors and equity holders. See *Matter of Chung King, Inc.*, 753 F.2d 547, 549 (7th Cir. 1985). The ability to achieve the highest price would be undermined if bankruptcy sales were not considered final at the conclusion of an auction, unless clear evidence of impropriety in the sale process has been demonstrated. If the bidding process were easily reopened, the bidding process would chill future interest in purchasing property from a bankruptcy estate, because bidders would not feel secure at the conclusion of an auction, *In re The Charter Co.*, 829 F.2d 1054, 1055 n.1 (11th Cir. 1987), cert. denied sub nom. Cargill, Inc. v. Charter Int’l Oil Co., 485 U.S. 1014 (1988), thereby driving down the market value of the bankruptcy estate property in general. See *In re Northern Star Indus.*, 38 B.R. 1019, 1022 (E.D.N.Y. 1984). If parties are to be encouraged to bid at bankruptcy auctions “there must be stability in such sales and a time must come when a fair bid is accepted and the proceedings are ended.” *In re Webcor, Inc.*, 392 F.2d 893, 899 (7th Cir. 1968); see, e.g., *In re Food Barn Stores, Inc.*, 107 F.3d 558, 564 (8th Cir. 1997) (“Finality and regularity of proceedings are significant factors whenever the courts are involved in a sale of property, for devotion to those principles encourages fervent bidding and ensures that interested parties will sincerely extend their best and highest offers at the auction itself.”); *In re Stanley Eng’g Corp.*, 164 F.2d 316, 319 (3d Cir. 1947) (“Public policy requires stability in such sales. . . . To induce bidding at such sales and
reliance upon them, the purpose of the law is that they shall be final . . . they are not to be disturbed except for substantial reasons.”).

Indeed, as the First Circuit declared in In re Gil-Bern Industries, Inc., 526 F.2d 627 (1st Cir. 1975):

It might not only be thought improper for a bankruptcy court to proceed in an irregular fashion merely to gain a few extra dollars in one case, but in the long run such a practice would be penny wise and pound foolish. Creditors in general would suffer if unpredictability discouraged bidders altogether. At the least such practices might encourage low formal bids.

Id. at 629 (citing In re Stanley Eng’g Corp., 164 F.2d at 319); see generally In re The Charter Co., 829 F.2d 1054, 1055 n. 1 (11th Cir. 1987) (“[R]eopening the bidding after the highest bidder has spent considerable time and money negotiating a contract could chill future interest in purchasing bankruptcy estate property.”); Stanley Eng’g, 164 F.2d at 321 (“It cannot be tolerated that it be in the contemplation of [bidder] to wait until after the property has been struck off to the other, and then open the bidding and defer the sale by an increased offer.”) (citations omitted); In re Bigler, LP, 443 B.R. 101, 112 (Bankr. S.D. Tex. 2010) (“To reopen the bidding process to allow [a losing bidder] to make its late bid would be an abuse of this Court’s discretion. Accordingly, this Court will not reopen bidding.”).

Typically, evidence justifying vacating a bankruptcy sale will involve collusion between bidders, or between sellers and bidders, or some type of fraudulent behavior. See, e.g., In re Made in Detroit, Inc., 414 F.3d 576, 581 (6th Cir. 2005); In re Colony Hill Assoc., 111 F.3d 269, 276 (2d Cir. 1997); In re Abbotts Dairies of Pennsylvania, Inc., 788 F.2d 143, 147-48 (3d Cir. 1986); In re Beck Indus, Inc., 605 F.2d 624 (2d Cir. 1979) (holding that collusion between bidding parties resulted in chilling auction price); In re Hat, 310 B.R. 752 (Bankr. E.D.Cal. 2004) (setting aside sale because price was chilled by an agreement between would-be bidder and non-bidding party with right of first refusal); In re Tri-Cran, Inc., 98 B.R. 609 (Bankr. D.Mass. 1989) (setting aside sale because purchaser colluded in order to obtain lowest possible sale price). Cf. In re Reading Broad., Inc., 386 B.R. 562, 576 (Bankr. E.D. Pa. 2008) (approving sale where “there was no improper conduct by the trustee or any of his agents in seeking the highest auction price for the station assets. Nor was there any evidence of collusion involving potential bidders.”).

In Foamex, the bankruptcy court reopened an auction because the debtor should have accepted another bid as the highest or best offer. See Transcript of Record, In re Foamex Int’l Inc., No. 09-10560 (KJC) (Bankr. D. Del. May 21, 2009) [Docket No. 485]; see generally Douglas Mintz, Michael Stevens, So You Want to Sell (or Buy) A Company Under Section 363? Here’s How, Bankruptcy Law Reporter (BNA). In Foamex, the debtors selected a cash bid that was $5 million lower than the stalking horse’s cash bid because the stalking horse’s offer included a credit bid. The court declared that, although the debtors complied with the bid procedures, the debtors should have accepted the stalking horse’s bid as the highest and best offer. Transcript of Record, at 75, 77, In re Foamex Int’l Inc., No. 09-10560 (KJC) (Bankr. D. Del. May 21, 2009) [Docket No. 485]. Thus, the court reopened the auction and directed the
debtor's to allow the stalking horse to bid. The Debtors then selected the stalking horse’s bid as the highest or best bid. See D. Mintz et al., So You Want to Sell (or Buy) A Company Under Section 363? Here’s How, Bankruptcy Law Reporter (BNA).

Bidding also may be reopened if “the price brought at the sale was so grossly inadequate as to shock the conscience of the court.” In re Stanley Eng’g Corp., 164 F.2d 316, 321 (3rd Cir. 1947); see Gil-Bern Indus., 526 F.2d at 629 (1st Cir. 1975) (“[I]t is an abuse of discretion for a bankruptcy court to refuse to confirm an adequate bid received in a fairly conducted sale merely because a slightly higher offer has been received after the bidding has closed.”); Food Barn, 107 F.3d at 564 (quoting Stanley Eng’g); In re Bryan, 2013 BL 233972, 2 (Bankr. M.D. Ala. Sept. 03, 2013) (quoting Stanley Eng’g). In In re Hart’s Mfg. Co., 383 B.R. 720 (Bankr. W.D. Tenn. 2008), the court refused to approve a sale where the purchase price was 1/6 of the appraised value of the property. Id. at 726.2

2 Generally, creditors have standing to appeal a sale or other disposition of assets, but disappointed prospective purchasers do not. Calpine Corp. v. O’Brien Envtl. Energy, Inc. (In re O’Brien Envtl. Energy, Inc.), 181 F.3d 527, 531 (3d Cir. 1999) (citing In re Gucci, 126 F.3d 380, 388 (2d Cir. 1997)). A prospective purchaser could have standing to challenge either the “intrinsic fairness” of the bidding process or the good faith of the ultimate purchaser. See O’Brien, 181 F.3d at 531; In re Volpe Indus., Inc., No. BR 10-20843-FJB, 2013 WL 4517983, at *3 (D. Mass. Aug. 23, 2013), appeal dismissed (Mar. 3, 2014) (“courts have found that even a mere unsuccessful bidder has standing to challenge the ‘inherent fairness’ or ‘intrinsic structure of the sale’”); Dick’s Clothing & Sporting Goods, Inc. v. Phar-Mor, Inc., 212 B.R. 283, 289 (N.D. Ohio 1997) (noting that “an unsuccessful bidder had standing to challenge a bankruptcy sale to the extent [the unsuccessful bidder] alleges that [the purchaser’s] actions destroyed the ‘intrinsic fairness’ of the sale transaction so that it was not a good faith purchaser”) (quoting Kabro Assocs., LLC v. Colony Hill Assocs. (In re Colony Hill Assocs.), 111 F.3d 269, 274 (2d Cir. 1997); In re Hat, 310 B.R. 752, 758 (Bankr. E.D. Cal. 2004) (quoting Colony Hill).

In Matter of Trumbull, 77 B.R. 374 (Bankr. D.Conn. 1987), the court considered the allocation of sale proceeds. The court declared that “the value of the collateral if retaken by the Bank under its security documents and thereafter sold would be $21,150.00, and that the lease value is $60,000.00, the sale of the lease and the collateral together to the buyer thereby increased their combined value by $83,850.00 (i.e., $165,000.00 minus $81,150.00).” Id. at 375. The court then acknowledged that “[n]either the parties nor the court have been able to locate any decisional authority on how to handle what would seem to be a common occurrence.” Id. The court held that “an equitable method to deal with the $83,850.00 increment is to divide it between the Bank and the trustee in proportion to their interests.” Id. at 375-76.

In LTV Steel, the court was charged with allocating $80 million in cash sale proceeds to several assets that were sold as one unit. Id. at 267. As the assets were sold as a going concern, the court concluded that the assets should be valued as a going concern, not on a liquidation basis. See id. at 269-70; In re Adam Aircraft Indus., Inc., No. 12-CV-01573-CMA, 2013 WL 773044, at *6 (D. Colo. Feb. 28, 2013), appeal dismissed (May 13, 2013) (“Because AAI Acquisition bought all of the Debtor’s assets in order to continue operations of the company as a going concern, a liquidation value standard would not have been appropriate.”); H.R.Rep. No. 595, 95th Cong., 1st Sess. 356 (1977), reprinted in 1978 U.S.Code Cong. & Admin.News 5963, 6312 (“‘Value’ does not necessarily contemplate a forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case.”).
The LTV Steel court declared that, “[w]hen several assets are sold as one unit, Courts determine the value of each asset based upon competent evidence.” LTV, 285 B.R. at 267; see also Weinman v. City of Pueblo (In re Adam Aircraft Indus., Inc.), 2012 BL 71031, 6 (Bankr. D. Colo. Mar. 23, 2012) (choosing agreed upon scheduled value of assets as a basis to allocate the sale proceeds because it “fits the requirement of allocating sale proceeds by attributing them to individual assets”). The debtor valued each of its assets based on a combination of prior offers and expert testimony regarding going concern valuations.

The court accepted the debtor’s assertion that its Short-line Railroad, Prepaid Expenses, and Cleveland Natural Gas Reserves (collectively, the “non-pro rata assets”) should receive an allocation of the sale proceeds equal to 100% of their value, or $13.37 million. The court then concluded that the value of the debtor’s remaining assets, including its steel-producing facilities, totaled $115.9 million. These assets were deemed the “pro rata assets.” To allocate the remaining sale proceeds to the pro rata assets, the court subtracted the value of the “non-pro rata assets” ($13.37 million) and the sale expenses ($15 million) from the $80 million in sales. The remaining sale proceeds totaled $51.63 million. The court then multiplied the percentage of each of the pro rata assets to the total value of the pro rata assets by $51.63 million to determine the portion of the sale proceeds allocated to each asset. For example, the Hennepin works facility was valued at $84 million, which is 72.47627265% of the total $115.9 million in value of the pro rata assets. Accordingly, 72.47627265% of $51.63 million (the remaining sale proceeds), or $37,419,499.57 in sale proceeds were allocated to the Hennepin works facility.

In In re Nortel Networks, Inc., 2015 BL 140852, at *26 (Bankr. D. Del. 2015), the court adopted a “modified pro rata” distribution model that provided a pari passu pro rata distribution to all creditors of all entities that were part of a multi-national enterprise. The court explained that “[t]he return to unsecured creditors from a pro rata distribution model would be dictated by a number of factors including the ultimate level of unsecured claims and equitable alternative to an allocation based on the legal rights of the Nortel Debtors in the underlying assets sold. Nortel operated prior to insolvency as a highly integrated multinational that derived significant benefits from operating as ‘one Nortel’.” Id. at 28. The court reasoned that a pro rata distribution model was most appropriate for the following reasons (without limitation):

(a) Nortel was a technology company whose most valuable asset was its intellectual property assets;

(b) the assets that were co-developed, jointly used and collectively sold by the members of Nortel . . . that they should properly be considered as representing a common pool of assets of Nortel as a whole;

3 Compare In re Residential Capital, LLC, 501 B.R. 549, 602-03 (Bankr. S.D.N.Y. 2013) (rejecting expert’s allocation of sale proceeds where, “[i]n applying his own methodology to allocate the value of the HFS Portfolio between JSN and non-JSN Collateral,” the expert “disregarded the actual purchase prices that Berkshire Hathaway agreed to pay for the collateral” and declaring that “[w]here, as here, an asset is sold in an arm’s-length transaction, the fair market value of such asset is conclusively determined by the price paid.”).
(c) there exists no more credible, reliable, equitable or economically rational manner with which to disentangle those assets (most of which are intangible) and ascribe value to component parts rather than the Pro Rata Distribution Model; and

(d) in particular, and contrary to the allocation position of the U.S. Debtors and the Canadian Debtors, there was no ex ante agreement as to the distribution of the jointly used assets of Nortel when it ceased to do business . . . .

Id. at 28.
ABI Winter Leadership Conference

Modern Day §363 Sale Practices

December 5, 2015
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  - $4.1 Billion Outstanding Debt
    - $1.1 Billion First Lien
    - $250 Million 1.5 Lien
    - $1.161 Billion Second Lien
    - $382 Senior Subordinated Note
    - $877 PIK Notes
  - Plan Provided for Payment of First and 1.5 Lien Notes in Cash But Without Make Whole Premium IF Class Voted to Accept the Plan
  - IF Class Voted to Reject the Plan, Class Would Get Replacement Notes
    - Principal Amount of Claim
    - Interest to Satisfy Cramdown Requirements
- First Lien and 1.5 Lien Notes Voted to Reject the Plan and Objected to Confirmation In Part on the Grounds that the Plan Was Not Fair and Equitable
Momentive: Lessons on Price - Legal Backdrop

- Section 1129(b)(2)(A)(i)
  - Secured Creditors not receiving immediate cash payment must receive “deferred cash payments totaling at least the allowed of such claim, of a value, as of the effective date of the plan, of at least the value of such holder’s interest in the estate’s interest in such property”
  - Present value of replacement notes must equal value of secured claim

- United States Supreme Court Decision in *Till v. SCS Credit Corp*, 541 U.S. 465 (2004)
  - Chapter 13 Case from 2004
  - Formula Approach: Risk Adjusted Prime Rate
  - Court noted 1-3% would be an appropriate risk adjustment in most cases
  - Court suggested that in Chapter 11 the answer might be to look at the market rate (in a footnote)

- Second Circuit decision in *In re Valenti*, 105 F. 3d 55 (2d Cir. 1997) also used a formula approach

- Sixth Circuit and others had adopted a market rate/coerced loan approach
Momentive: Lessons on Price - The Decision

- Adopted a Formula Approach
  - Supreme Court and Second Circuit Provided “Clear” Guidance
- Rate should be based on a riskless or close to riskless base rate
  - No profit component
  - Not a new loan
  - No real “market” exists as DIP is not relevant and exit financing contains a profit component
  - Just intended to be the present value of the claim (i.e. repayment)
- Treasury not Prime Rate Because it is a Rate for Longer Term Debt
- Risk Adjustment Range Could be Increased Because Treasury not Prime Rate was Used
ABI 2015 Winter Leadership Conference

Modern Day §363 Sale Best Practices

Presented by: Samuel Star, Senior Managing Director, FTI Consulting, Inc
§363 Sale Process – Hypothetical Timing

Buyer/Stalking Horse Bidder Identified

Additional Diligence/APA Negotiated

File Bid Procedures Motion

Notice Period

Bid Procedures Hearing (Approved)

Asset Marketing; Due Diligence for other Potential Bidders

Debtor/UCC Select Lead Bid

Auction (If Necessary)

Sale Hearing (Approved)

Closing (Accelerated)

30 – 45 Days

10 Days

30 – 60 Days

1 Day

5 Days

10 Days

Appeal Period
§363 Asset Sale Study

Deal Size: $125M+
Time Frame: August 2012-August 2015
# of Deals: 25

<table>
<thead>
<tr>
<th>Credit Bids&lt;sup&gt;(1)&lt;/sup&gt;</th>
<th>Stalking Horse Wins&lt;sup&gt;(2)&lt;/sup&gt;</th>
<th>Timing in Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>14</td>
<td>3 - 80 to 5 - 308</td>
</tr>
<tr>
<td>% of Sample</td>
<td>56%</td>
<td>30 to 85</td>
</tr>
<tr>
<td></td>
<td>18</td>
<td>22 to 60</td>
</tr>
</tbody>
</table>

Notes:
(1) Of the 14 credit bids, 7 had additional cash components.
(2) Based upon 24 cases as one case in the sample population did not include a stalking horse bidder.
(3) Refers to the date that an asset sale is announced; either on the petition date or subsequently.

Source: Deal Pipeline, Court Filings
Deal Size: $125M+
Time Frame: August 2012-August 2015
# of Deals: 25

<table>
<thead>
<tr>
<th>Bidding Procedure Components (4)</th>
<th>Break-up Fee (5)</th>
<th>Expenses (5)</th>
<th>Bid Increments</th>
<th>Deposit (6)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Range</td>
<td>0% - 4.0%</td>
<td>0% - 2.1%</td>
<td>0% - 1.9%</td>
<td>1.6% - 14.0%</td>
</tr>
<tr>
<td>Average</td>
<td>2.4%</td>
<td>0.8%</td>
<td>0.4%</td>
<td>6.8%</td>
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<tr>
<td>Median</td>
<td>3.0%</td>
<td>0.9%</td>
<td>0.3%</td>
<td>6.0%</td>
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</tbody>
</table>

Notes:
(4) Expressed as a percentage of stalking-horse bid unless stated otherwise.
(5) For cash bids only.
(6) Expressed as a percentage of bid value.

Source: Deal Pipeline, Court Filings
Bidding Procedures Issues

- **Time to Auction**
  - Liquidity
  - Level of pre-petition marketing efforts
  - Quality of data room
  - Access to management
  - Insider bidder vs 3rd party bidder
  - Strategic vs financial bidder
  - Complexity of business

- **Credit Bids**
  - “Free Option”
  - Quantify early?

- **Bid Deposits**
  - Cover assumed liabilities?
  - Need for credit bids?

- **Break Up Fees**
  - Applicable for credit bids?
  - Cover expenses?

- **Bidding Increments**
  - Fixed or flexible
  - Minimize?
Higher or Better?

<table>
<thead>
<tr>
<th></th>
<th>Bidder A</th>
<th>Bidder B</th>
<th>Bidder C</th>
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</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 100</td>
<td>$ 150</td>
<td>$ 200</td>
</tr>
<tr>
<td>Assumed Liabilities</td>
<td>150</td>
<td>90</td>
<td>30</td>
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<tr>
<td>Gross Purchase Price</td>
<td>$ 250</td>
<td>$ 240</td>
<td>$ 230</td>
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</table>

**Factors to Consider:**
- Quantification of assumed liabilities
- Nature of assumed liabilities
- Level of remaining claims
- Ability to close
## Higher or Better?

### Factors to Consider:
- Level of certainty
- Level of remaining claims
- Loss of jobs

<table>
<thead>
<tr>
<th></th>
<th>Bidder A</th>
<th>Ch 11 Liquidation</th>
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<tbody>
<tr>
<td>Cash</td>
<td>$100</td>
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<tr>
<td>Assumed Liabilities</td>
<td>50</td>
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<tr>
<td>Gross Purchase Price</td>
<td>150</td>
<td>Asset Liq. Proceeds</td>
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<tr>
<td>Incremental Severance/Wind down</td>
<td>-</td>
<td>(20)</td>
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<tr>
<td>Net Proceeds Available</td>
<td>$150</td>
<td>$155</td>
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