

Negotiating Successful Workout Agreements: The Human Element

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Negotiating Successful Workout Agreements: The Human Element

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Hypothetical Fact Scenario

- Debtor business – manufacturing & sales
 - 8 locations in U.S. (own 3/lease 5)
 - Started as family business in 60's
 - Big expansion in 90's
 - Losing ground last 6-8 years to foreign competition
- Ownership structure
 - Holding co. with 2 subs (1-real estate; 1-operations)
 - Family owns 65%
 - Venture capitalist owns 35% (purchased 2010)
- Management
 - President – Patriarch
 - VP-Operations – First Son
 - VP-Sales – Second Son
 - CFO – Outsider hired 18 months ago
 - Secretary – Daughter (was Treasurer until CFO hired)
- Board of 8 members (5 until 2010)
 - 5 – Family
 - 3 – Venture capitalist
- By Laws amended in 2010
 - 2/3 vote required for major decisions (financing, sale of assets, bankruptcy)

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Hypothetical Fact Scenario (continued)

- Capital Structure
 - Bank – operating line of credit-secured by senior blanket UCC Lien
 - Equipment financing – several finance leases
 - 3 local banks hold 3 different mortgage loans on 3 pieces of real estate
 - Venture Capitalist – second lien on everything to secure term loan
 - Suppliers – long-time U.S. suppliers and new Chinese suppliers primarily on 2 of 3 product lines
- Current Financial Status
 - Operating line – covenant default
 - Real estate loans & leases – all current
 - Equipment leases – 1-2 months behind
 - VC loan – current but cross-default on operating line
 - Stretching suppliers:
 - U.S. – 60-75 days
 - Chinese – 30-45 days

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Initial Meeting of Restructuring Professionals called by newly-hired consultant for Debtor

Debtor's consultant – Becky

Debtor's attorney – Ben

Bank's consultant – Daniel

VC's consultant – Laura

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THANK YOU

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**35th Annual Midwestern Bankruptcy Institute—Kansas City, MO
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**NEGOTIATING SUCCESSFUL WORKOUT AGREEMENTS:
THE HUMAN ELEMENT**

- ¹ I. Hypothetical Fact Situation (no numbers to avoid economic fact influence)
- A. Debtor business
1. Manufacturing and Sales – originally products for one industry-now three separate families of products for three related industries
 2. Eight locations in U.S.
 - a. Own 3/lease 5
 - b. Some locations for all products, some only for one product line
 3. Started as family business in the 60's
 4. Big expansion in 90's
 5. Losing ground last 6-8 years to foreign competition
- B. Ownership Structure
1. Holding company with 2 subsidiaries/1 for real estate; 1 operating entity
 2. Family owns 65%
 3. Venture capitalist (VC) owns 35% purchased in 2010.
- C. Management
1. President – Patriarch
 2. VP-Operations – First Son
 3. VP-Sales – Second Son
 4. CFO – outsider hired 18 months ago
 5. Secretary – Daughter (was Treasurer until CFO hired)
 6. Board – 8 members (was 5 until 2010)
 - a. 5 members – family
 - b. 3 members – VC

¹ will be used in presentation of Issues/Discussion and Human Factors

7. Bylaws amended in 2010 to require 2/3 board vote for major decisions
 - a. New financing
 - b. Sale of assets
 - c. Filing bankruptcy
- D. Capital Structure
 1. Traditional bank operating line of credit – senior blanket UCC lien
 2. Equipment Financing – several finance leases
 3. 3 local banks – 3 different mortgages on each of 3 owned pieces of real estate
 4. VC – second lien on everything to secure term loan
 5. Suppliers – long-time US suppliers and new Chinese suppliers primarily on 2 of 3 product lines
- E. Current Financial Status
 1. Covenant default on operating loan
 2. Real estate loans and leases – all current
 3. Equipment leases – behind 1-2 months
 4. VC current but cross-default with default on operating line
 5. Stretching all suppliers
 - a. U.S. suppliers – mostly 60-75 days
 - b. Chinese Suppliers – mostly 30-45 days
- F. Restructuring Team
 1. Frank Melazzo hired by company at recommendation of CFO based on prior experience as CRO
 2. Laura Marcero – consultant for VC
 3. Daniel Wiggins – Lender’s Monitor
 4. Ben Mann – Company’s bankruptcy counsel

- II. Issues/Discussion Subjects
 - A. Reduce Expenses
 - 1. RIF
 - 2. Cut salary
 - 3. Close locations
 - 4. Demand price reductions for suppliers on threat to change
 - B. Increase Revenue/Cash
 - 1. Raise price of products
 - 2. Increase amount of loans
 - 3. Obtain further investment of funds from current shareholders
 - C. Change Terms of Secured Debt
 - 1. Lower interest rate
 - 2. Extend term
 - 3. Take haircut on debt
 - D. Change Terms of Unsecured Debt
 - E. Employee Morale/Knowledge Level
 - 1. What to tell them
 - F. Management
 - 1. Competency
 - 2. Need for change
 - G. Concerns about publicity associated with workout
 - 1. Disclosure to employees
 - 2. Proposals to creditors or other third parties
 - 3. Press and social media
 - H. Whether to File for Bankruptcy
 - 1. Impact on customers
 - 2. Impact on suppliers
 - 3. Impact on employees

- I. Sale of Business
 - 1. Sale of some locations
 - 2. Sale of all
 - 3. Outside or inside bankruptcy

² III. Human Factors

- A. Perception of Consultant
 - 1. Debtor owners
 - a. Resentment
 - b. Distrust
 - c. Outsider doesn't know the business
 - d. Working for creditor not debtor
 - 2. VC creditor
 - 3. Bank Lender
 - 4. Employees
- B. Consultant
 - 1. Building trust
 - 2. Building relationship
- C. Personal Relationship Among Family Members
 - 1. Patriarch – knows what to do
 - 2. Incompetency of some siblings – how to address with patriarch
- D. VC Creditor/Owner
 - 1. Keeping creditor/owner goals separate
 - 2. Relationship with Family and VC
 - 3. Personality of VC rep
 - a. Other issues within company
 - b. New rep/old rep
- E. Bank Lender

² all of the human factors in III will be discussed in context of each issue/discussion subject
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1. Skeptical of ability to reorganize
 2. Skeptical of VC commitment to business
 3. Current loan officer's relationship with loan file
- F. Personal Issues with Suppliers
1. Long time domestic suppliers resent losing business to Chinese suppliers
 2. Have worked over years with Debtor
- G. Personal Issues with all Creditors
1. Resent debtor characterizing situation as "being partners and need to share pain"; never offered to "share the gain" in good times
 2. Already made concessions
- H. Employees
1. How to deal with employee morale
 2. Tell everything and people will leave
 3. Say nothing and rumor will fill void
- I. Managing Expectations
1. Debtor – cannot save it all
 2. Creditors – must give up something
- J. Negotiating Strategies
1. Method of Communications
 - a. Face to face
 - b. Teleconference
 - c. Emails
 - d. On the record/off the record/back channel
 2. Perception of your adversary
 - a. "Negotiating with a terrorist" – trying to reason with a party who is unreasonable
 - b. Win/win – looking for a compromise or splitting the baby
 - c. Win/lose – all or nothing or get more then you give up

3. Use of a third party as the “bad cop” who will decide if two parties fail to resolve
 - a. If we can’t figure out to resolve this, it will be turned over to lawyers
4. How to use distinction of reality/perception in negotiating