

The Art of Auctioning in Bankruptcy

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I. INTRODUCTION AND BACKGROUND

The panel discussion and supplemental materials will address auction strategies and techniques in Section 363 sales and assets sales. We will also discuss the practice of claims trading and pre-petition debt buying by private equity firms as well as due process issues and information adequacy in first day sale motions. An objective approach to a successful sale process that balances game and auction theory with practical application will demonstrate the subjective art of auctioning in bankruptcy.

A. Background: Auctions under § 363

1. Legal perspective

- a. 363 sale benefits vs. out-of-court asset sale
- b. “Free and clear” standards
- c. Releases, creditor rights and *sub rosa* plans

2. Economic considerations

- a. Wasting assets and the “melting ice cube”
- b. Flexibility compared to plan of reorganization
- c. Credit bidding and sale currency

II. §363 SALES

A. Game theories

1. Application of auction theory to bankruptcy process

- a. Auction methods and appropriate use in bankruptcy
 - i. English auction

- ii. Sealed bid auction
 - iii. Dutch auction
 - iv. Vickrey auction
 - b. Behavior of bidders in auction environment
- 2. Pattern for bankruptcy auctions and opening moves
 - a. Asset purchase agreements – structure and content to establish dominant position
 - b. Bid procedures – structure and content to encourage bidding and provide clarity
 - c. Steps from initial marketing phase to final sale order and practice aids
 - i. Form agreements (confidentiality, common provisions for bid procedures and sale orders)
- B. Strategies to win an auction
 - 1. Bidder motivation by auction structure
 - a. Appetite for risk
 - b. Valuation
 - c. Transaction costs
 - 2. Stalking horse bidders and opening moves
 - a. Role of the stalking horse bidder and required protections/defensive positions
 - b. Effect on auction process and value
 - 3. Disclosures and effect on value

III. PRIVATE EQUITY ANGLE

A. Claims trading

1. Type of Claims Bought/Sold; Timing for trading; purchase price
 - a. Bankruptcy requirements for claims trading –Bankruptcy Rule 3001
 - b. Limitation on Credit Bid (do you have an allowed claim?)
 - c. Goals for acquiring/selling claims

B. Pre-petition debt buying

1. Purchase of Secured Debt
 - a. Prepetition Lender: gives you rights as a secured credit with credit bidding opportunity and gives you standing as a creditor in the bankruptcy case with possible limitations if second lien debt per intercreditor agreement
 - b. Postpetition Lender: allows you to prime existing secured loans and obtain first right of repayment; gives you credit bidding opportunity; DIP terms may control sale milestones
2. Purchase of Unsecured Debt
 - a. Public debt vs private debt
 - b. Gives you standing as a creditor; may influence case outcome that is favorable to investment
 - c. Possible seat on the creditors committee

IV. FIRST DAY SALE MOTIONS

A. Prepetition planning

1. Impact of venue, local rules and procedures
2. Pre-petition marketing/solicitation

3. Deal/sale structure
 4. Resources to effectuate process (near and mid-term cash flow)
 5. Involvement of lender and other critical players
 6. Roles of various professionals
 7. Contract and lease analysis and proposed treatment
 8. Assessment of potential delay and other contingencies
- B. Due process issues
1. Timing of proposed sale
 2. Identifying all parties in interest
 3. The impact of the nature of assets being sold and corresponding liabilities
 - a. Understanding “interests in property” and the ability to divest the same
 - b. Are there environmental liabilities?
 - c. Are there mass tort or toxic tort issues?
 - d. Product line liability?
 - e. Labor and employment claims
 4. Notice options
 5. Adequacy of information and dissemination
- C. Contingency planning