Akerman's Private Equity Boot Camp Series: Distressed Company Transactions

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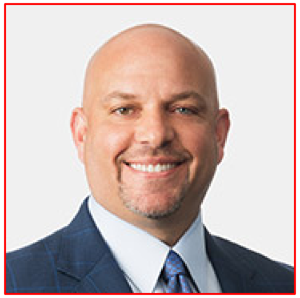
Contact Us

PRESENTERS:

Martin G. Burkett
Co-Chair, M&A and Private Equity Practice
Telephone: 305.982.5578
Email: martin.burkett@akerman.com



Karyn Koiffman
Partner, M&A and Private Equity Practice
Telephone: 202.824.1729
Email: karyn.koiffman@akerman.com

John E. Mitchell
Partner, Bankruptcy and Reorganization Practice Group
Telephone: 214.720.4344
Email: john.mitchell@akerman.com

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Overview/Sale Process

Distressed Transactions Outside of a Proceeding – *asset values are there but…*

- Seller's primary concerns
  - Fair value
    - Cost of FV opinion / benefit?
  - Board fiduciary duties
- Buyer's primary concerns
  - Fraudulent transfer avoidance (4 years)
  - Value of solvency opinion
  - Other theories (alter ego, continuing business ent., etc.)

Bankruptcy Overview

- Chapter 11 v. Chapter 7
- Solvency test?
  - Some economic distress
  - Valid business reason / justification
- Debtor in possession:
  - Remain in possession of assets / company
  - Operate in ordinary course
- Stages of a Chapter 11: stabilize, restructure, exit

Bankruptcy Sales

- 11 U.S.C. § 363(b):
- Sales outside ordinary course of business requires bankruptcy court approval
- Must obtain highest and best price for assets
- Can be some or all of debtor's assets
  - Including going concern sale or equity purchase

Sale Process Overview

- Process tailored to particular sale
  - Sometimes very informal, but always subject to higher offers
- Normally 30 to 90 Days (could be shorter or longer)
- Initial process similar to traditional sales:
  - Investment banker / broker, data room, teasers, NDAs, CIM
- Auction: In/Out of courtroom
  - Selection of highest & best bid, other considerations
- Court approval at (*quick*) sale hearing
  - Potential challenge by bidders and parties in interest

Unique Advantages and Other Terms

- No subsequent fraudulent transfer risk.
  - Court order finds fair value for assets
- Similar protection for seller
  - No need for fairness / value opinion for board
  - Court will make that finding
- Assets sold “free and clear”
  - Assets with “hair” on them cleansed / limited exceptions
- Good faith finding prevents reversal on appeal
  - (11 U.S.C. § 363(m))

Unique Advantages and Other Terms

- No bulk transfer liability
- Restrictive governance approval not required
  - i.e. majority shareholder or other
  - Board + creditors + court
- Less due diligence of *liabilities r*equired
  - No liabilities assumed unless specifically agreed to
  - Court protection from successor liability

Certain Disadvantages

- Lender credit rights (*usually*) preserved
- Process not without risk
  - e.g., creditors' objections, unpredictability, other bidders
- Transparency & limited confidentiality
  - Bankruptcy courts require notice to parties
  - Media exposure
  - Discovery
- Court approval not guaranteed

Certain Disadvantages (cont'd)

- Transaction costs
  - Chapter 11 is expensive
- Short timeframe to conduct due diligence
  - Distressed debtors' financials, are they accurate?

Assumption of Contracts/Bidding Procedures/Stalking Horses

Assumption / Assignment of Executory Contracts

- Purchaser may choose which contracts to have assigned to it (assume & assign)
- Assumption / assignment standards
  - Contract assumed / assigned in its entirety, no severance of contract provisions
  - Purchaser / assignee must cure all defaults (monetary and non-monetary)
    - Purchaser / assignee must provide adequate assurance of future performance (monetary and other requirements of contract)
    - Cure amounts noticed to contract counter-parties. If no objections, then cure deemed at amount noticed. If objections, then court determination

Assumption / Assignment of Executory Contracts (cont'd)

- Anti-assignability provisions largely irrelevant:

  Exceptions:
  - Personal services contracts
  - Certain IP licenses
  - Government contracts

Bidding Procedures

- Bid and closing deadlines
- Bidder deposit of a percentage of the purchase price
- Bidder must demonstrate that it has financial ability to complete the transaction / no financing contingencies
- Minimum overbid amount plus break-up fees (2-4%) and expense reimbursement fee
- Markup of APA not materially more burdensome than the stalking horse APA
- Can be penalized in bidding process

Stalking Horses

- Advantages
  - More time and access to conduct due diligence
  - Head start on seeking regulatory approvals and R&W insurance
  - Sets the threshold price, contract terms and transaction structure
  - Competing creditors must bid against your APA
  - Receives certain bid protections, break up fees, expense reimbursement
  - Negotiates the bidding procedures and process

Stalking Horses (cont'd)

  - Creates strategic relationships with debtor and other significant players
  - Can provide financing to debtor for additional control
- Disadvantages
  - Time and expense
  - Risk of subsequent bids, being overbid
  - Very difficult to exercise termination provisions, creditors could / will challenge in court

Nuts and Bolts of Section 363 Asset Purchase Agreement (APA)

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Nuts and Bolts of Section 363 Asset Purchase Agreement (APA)

- Acquisition of assets and assumption of liabilities
- Purchase price
- Representations and warranties
- Closing conditions
- Covenants
- Termination
- Jurisdiction

Nuts and Bolts of Section 363 APA (cont'd)

- Acquisition of assets and assumption of liabilities
- Purchase price
  - Deposit
  - Cash and/or credit bid; cure amount; other consideration
  - Purchase price allocations (buyer vs seller interests)
  - Holdbacks and escrows typically more difficult to negotiate as creditors want certainty on net purchase price
  - Earn-outs and other contingent payments not likely
- Representations and warranties
  - No survival of representations and warranties post-closing
  - R&W insurance is available:
    - Mitigate losses not extinguished by "free and clear" order
    - Typical RWI requirements apply: fulsome business and legal diligence, etc.
  - Availability of other insurance in the context of distressed acquisitions

Nuts and Bolts of Section 363 APA (cont'd)

- Closing conditions
  - Generally no stockholder or contractual consents condition
  - Exceptions
    - Personal service contracts
    - Governmental contracts
    - Intellectual property
  - Regulatory consents still applicable
  - Hart-Scott-Rodino waiting period 15 days In bankruptcy context (as opposed to 30 days)
  - Bankruptcy process conditions
    - Court approval
    - Curing of defaults on assumed executory contracts and leases
    - Seller's DIP financing not being terminated or adversely modified

Nuts and Bolts of Section 363 APA (cont'd)

- Covenants
  - Conduct of business prior to closing typically contains fewer obligations and restrictions
    - Debtors must operate in ordinary course anyway
  - Bankruptcy process covenants
    - No exclusivity; competing transaction
    - Provisions regarding the assignment, assumption, and rejection of executory contracts and leases
    - Cooperation to obtain sale order and, if stalking horse, the bidding procedures
    - Seller to provide notices to parties in interest (creditors)
      - Court supervision

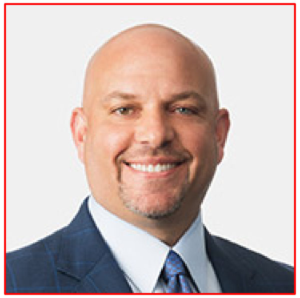
Nuts and Bolts of Section 363 APA (cont'd)

- Termination
  - Unique to Section 363 (besides standard provisions)
    - Buyer's right to terminate if court order not approved
    - Seller's right to terminate if alternative transaction
  - Effect of termination (break-up fee/expense/deposit)
    - If seller breaches or closes alternative transaction, stalking horse entitled to break-up fee and expense reimbursement
    - If stalking horse not in breach and transaction does not close, stalking horse entitled to expense reimbursement
    - If a buyer is in breach, deposit is forfeited (typically as sole recourse)
- Choice of law/venue
  - Customary choice of law
  - Venue of the bankruptcy proceeding for dispute resolution

Contact Us

FOR FURTHER INFORMATION AND QUESTIONS:

Martin G. Burkett
Co-Chair, M&A and Private Equity Practice
Telephone: 305.982.5578
Email: martin.burkett@akerman.com



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