Deal Trends, Current Terms, and Recent Developments in 363 Sales

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SECTION 363 SALES
AN OVERVIEW OF THEIR IMPORTANCE, TRENDS AND WHAT TO EXPECT IN THE NEAR FUTURE
BACKGROUND TO THE GROWING IMPORTANCE OF 363 TRANSACTIONS

Much has been written about the growing importance of 363 sales in Chapter 11 cases over recent years.

Principal reasons for this:

- Increasing amounts of outside capital seeking advantageous returns in distressed situations has encouraged growth of 363 transactions.

- Increasing cost and complexity of the Chapter 11 process has motivated diverse groups of creditors to push for the speed, certainty and simplicity of a 363 resolution.
Having looked at the underlying reasons behind the increasing importance of 363 sales, let’s take a statistical look at their role in the Chapter 11 Process in terms of their significance compared to total Chapter 11 filings, as well as the alternatives of plan confirmations and liquidation under Chapters 11 or 7.
TOTAL CHAPTER 11 FILINGS BY QUARTER 2005 THROUGH Q1 2012

Source: The Deal Pipeline.
TOTAL 363 TRANSACTIONS BY QUARTER
2005 THROUGH Q1 2012

Source: The Deal Pipeline.
TOTAL PLAN CONFIRMATIONS BY QUARTER 2005 THROUGH Q1 2012

Plan Confirmations as % of Total Ch. 11 Filings

Source: Bankruptcydata.com and The Deal Pipeline.
TOTAL CHAPTER 11 TO 7 CONVERSIONS BY QUARTER 2005 THROUGH Q1 2012

Conversions

Ch. 11 to Ch. 7 Conversions as % of Total Ch. 11 Filings

Source: Bankruptcydata.com and The Deal Pipeline.
WHAT’S IN STORE IN THE NEAR FUTURE FOR 363 TRANSACTIONS

The End of “Amend & Extend”

&

Other Upcoming Maturity Walls.
Two fundamental paths to bankruptcy exit:

- Plan
- Sale
Plan: substantial statutory framework for confirmation

- Section 1129 has 16 statutory requirements for confirmation, and most of those requirements have multiple sub-parts

- Sections 1121, 1123, 1124, 1126, and 1129, in the case of “cram-downs,” among others, add additional requirements for each plan

- Also additional statutory hurdles for other parts of plan process, including disclosure statements
Sale: largely defined by practice and precedent

- Section 363(b) authorizes sales outside of the ordinary course of business
- Certain sub-provisions of section 363 provide further guidance on certain sales, but there are no statutory requirements for sale process, auction, notice, or documentation
- Section 365 allows assumption and assignment of favorable agreements and rejection of unfavorable ones
- Through precedent and practice sales have evolved into a relatively well-established routine
Statutory Background
The only statutory language that is mandatory for each sale:

- 363(b): “The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate …”
Additional sale related provisions that may apply:

n 363(f): the trustee may sell property . . . free and clear of any interest in such property if …

n 363(k): . . . unless the court for cause orders otherwise the holder of [a secured] claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property

n 363(m): The reversal or modification on appeal of an authorization under subsection (b) … of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith …

n 363(n): The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential bidders at such sale …
Non-statutory practice

- Marketing requirements
- Stalking horse vs. open auctions
- Form and substance of Purchase Agreements
- Bid protections (breakup fees, expense reimbursement, overbid increments, qualified bidder requirements, deposits, etc.)
- Auction process
- Sale order/hearing
Standard of Review

- Substantially all decisions are examined through the prism of the business judgment rule (with heightened scrutiny for transactions with an insider)

- Maximize value; highest or otherwise best offer for the assets

- Best interests of the estate
Recent Trends:

- Breakup fees
- Indemnities
- MACs
- Closing conditions (hell or high-water provisions?)
- Deals & Deal Terms
Bidding structure and procedures
Largely unregulated

- Best interests of the estate
- Maximize value
Procedures

- No statutory guidance: process is defined entirely by what will produce “highest and otherwise best offer” for assets

- Practice has established recognizable pattern, but that pattern can be broken
Procedures (cont’d)

American Safety Razor

Very unorthodox process:
- Procedures not approved up front
- Debtor maintained ability to determine in its sole discretion who was qualified bidder, and to refuse diligence to anyone not so qualified

The Dispute:
- Debtor refused to qualify or accept bid from a competitor that was offering substantially greater value
- All parties were being paid in full except for Second Lien Lenders, and Intercreditor Agreement prohibited Second Lien Lenders from objecting
American Safety Razor (cont’d)

- Section 510(a): “A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law.”

- Natural questions:
  - Is an “intercreditor agreement” a subordination agreement?
  - To what extent is such agreement enforceable under nonbankruptcy law?

- Several cases have examined the pre-bankruptcy waiver of various creditor rights: voting on a plan, filing claim, the right to object to a plan or DIP

- As a general matter, these cases turn on whether the Court believes that the agreement contemplates the purported waiver of a fundamental statutory right
Procedures (cont’d)

n American Safety Razor (cont’d)

q Following objections, Court found:

n Court had obligation to ensure overall fairness and integrity of process

n Intercreditor Agreement prohibited Second Lien Lenders from objecting to sale, but did not preclude objection to sale process

n Court twice refused to approve sale as proposed by Debtor, eventually approving sale to competitor, as proposed by Second Lien Lenders

q Hard cases make bad law?
Schutt Holdings

- Auction lasted through the night; at 7 am one bidder made final bid to be accepted within 60 seconds
- Notwithstanding that second bidder was insisting on ability to overbid, company accepted first bid and ended auction
- At hearing, the auction results were approved and jilted bidder was not allowed to overbid
- Sale order also allowed, some would say without proper notice, the buyer to direct the allocation of proceeds, regardless of statutory priority
363(n) -- Collusive bidding

- Threat vs. reality
  - “The influence on the sale price must be an intended objective of the agreement, and not merely an unintended consequence …”

- When to tear down the walls
Substance of the Sales
363 vs. Sale Through a Plan

- Section 363 sale
  - Lower protections for creditors means heightened judicial scrutiny of sales

- Sale under a plan
  - Exclusivity under Section 1121(b)
    - *Spansion* and alternative plans

- The language of section 1129(a)
  - “The court **shall** confirm a plan . . . .”

- The language of section 1129(b)
  - “Notwithstanding section 510(a) of this title . . . .”
363 vs. Sale Through a Plan: Have Chrysler and GM driven a Fiat Subrosa Right Through Chapter 11 Plans?

What’s all the controversy over sales pursuant to Section 363 v. through a Plan of Reorganization?

- Basic Differences: Value Creation v. Value Distribution
- Why Debtors and Asset Purchasers Generally Prefer 363 Transactions
  - Speed
  - Cost
  - Simplicity
  - Insulation from Appeal
363 vs. Sale Through a Plan: Have Chrysler and GM driven a Fiat Subrosa Right Through Chapter 11 Plans?

Why Creditors Often Oppose 363 Transactions
363 vs. Sale Through a Plan: Have Chrysler and GM driven a Fiat Subrosa Right Through Chapter 11 Plans?

- Background of Chrysler & GM
363 vs. Sale Through a Plan: Have Chrysler and GM driven a Fiat Subrosa Right Through Chapter 11 Plans?

The Sub-Rosa Arguments
363 vs. Sale Through a Plan: Have Chrysler and GM driven a Fiat Subrosa Right Through Chapter 11 Plans?

- The Model 363 Beats the Fiat Subrosa
363 vs. Sale Through a Plan: Have Chrysler and GM driven a Fiat Subrosa Right Through Chapter 11 Plans?

» The Post GM/Chrysler Limits of Section 363
  » Legitimate Business Purpose
  » Best Interests Test Met
  » Highest and Best Transaction Available
  » Delay Will Cause Transaction Loss and Further Diminution in Asset Value
  » The Only Alternative is a Less Advantageous Liquidation.

» Conclusion
Texas Rangers Offensive Prepack

HSG Sports Group
(Hicks Sports Group)
Primary Obligor of
$525 Million Indebtedness

Rangers Equity LP
Guaranteed $525 Million

Rangers Equity GP
Guaranteed $525 Million

Texas Rangers Baseball Partners
Guaranteed $75 Million

Rangers Ballpark LLC
Guaranteed $525 Million
**Terms of the Prepack**

- Provided for a sale of substantially all of the assets of the Texas Rangers Baseball Club to Rangers Baseball Express LLC, an entity controlled by Chuck Greenberg and Rangers President and Hall of Fame pitcher, Nolan Ryan.

- Creditors of TRBP were to receive payment in full.

- Most claims were to be assumed by the purchaser.

- Claims not assumed by the purchaser were to be paid from the proceeds of the sale, including the $75 million in guarantee obligations under the HSG credit agreements.
Texas Rangers Key Pre-Confirmation Issues

- Does a solvent debtor have a duty to creditors to maximize value? 
  No. Normal corporate governance applies, so a solvent debtor may agree to any deal that its equity holders agree to.

- Who is entitled to speak for the Equity Parents? 
  Not the Lenders.

- After they are in bankruptcy, what duties do the Equity Parents owe the Equity Parents’ lenders? 
  Same duty as a trustee for the Equity Parents would have.

- Are the lenders or Equity Parents impaired? 
  Lenders: Maybe. Equity Parents: Yes.
Auction Held Because Equity Parents, Now in Chapter 11, Have a Duty to Their Creditors to Maximize Value

On May 28, 2010, the Lenders filed involuntary Chapter 11 cases against TRBP's Equity Parents

CRO was appointed for the Equity Parents

CRO was required to maximize value in the Equity Parents’ cases in determining how to vote on the Plan

CRO had the power to:

1) Vote for the Plan

OR

2) Withhold his vote and force an auction (the option the CRO selected)
Maximizing Value in the Equity Parents’ Case Became the Key Issue

- Pre-confirmation, the Court advised:
  - Plan would be evaluated on going-concern value, not liquidation value, because a trustee would market the assets as a going-concern enterprise
  - Existence of multiple bidders with no impediments to bidding is proof that the assets were subject to an appropriate market test
  - Even if multiple bidders did not show up to the auction, the Plan could nevertheless be confirmed if the Debtor could establish that the prepetition sale process constituted a fair market test for the assets
  - The test under Section 1129(a)(7) was subsumed by Section 363 because the Equity Parents were casting their votes while in Chapter 11
Bankruptcy Code vs. Applicable Non-Bankruptcy Laws

- Sports franchises – does sale require consent of league, commissioner, etc.
  - Issues Specific to Baseball (Texas Rangers, Dodgers):
    - Any sale or financing of MLB clubs is subject to the MLB Constitution
    - Any sale is subject to a ¾ vote of all MLB owners
      - Related timing issues (sale approved by MLB owners post-auction and post-confirmation)
    - Historical Baseball Antitrust exemption
    - The MLB Commissioner’s “best interests of Baseball” power may be exercised to revoke a franchise (untested)
Bankruptcy Code vs. Applicable Non-Bankruptcy Laws

q Issues Specific to Hockey (Phoenix Coyotes, Dallas Stars):
   n Subject to \( \frac{3}{4} \) vote of the NHL Board of Governors
   n Timing of approval different than in baseball
      q NHL Board of Governors approved sale of Dallas Stars prior to sale approval/confirmation hearing
   n *Phoenix Coyotes* precedent
   n No Antitrust exemption
Bankruptcy Code vs. Applicable Non-Bankruptcy Laws

- Intellectual Property
  - U.S. Law may not always govern
  - Trademarks—not “intellectual property” under the Bankruptcy Code
Sale free and clear

“free and clear of any interests in such property”

...
Retail Cases

- Unique bidding procedures when time is of the essence
- Going concern bids vs liquidation bids vs hybrid bids (and disguised liquidations)
- Breakup fees and credit bidding in the retail context
- Out of court options
- Retail-specific issues that typically arise at the sale approval hearing