Distressed Company M&A: Approaches & Current Issues

James Baillie
Clinton Cutler
Ryan Murphy
Simon Root

June 17, 2020
I. Introduction
Focus for Today

• A private company target still operating to be acquired
• Target’s liabilities more than (current) enterprise value
• Target is not (yet) in bankruptcy
• Today:
  – Distressed Company M&A Outside of Bankruptcy
  – Distressed Company M&A In a Bankruptcy
  – Comparison
II. Distressed Company M&A Outside of Bankruptcy
Non-Bankruptcy

• Impact on Buyers: Equity Deals
  – Negotiated workouts with creditors

• Impact on Buyers: Asset Deals
  – Creditor Successor Liability Claims
    • Higher risk for tax, pension, environmental and other favored creditors
  – Creditor Fraudulent Transfer Claims
    • Claim that Buyer did not pay “reasonably equivalent value”
    • Creditor leverage and time to assert
    • Buyer defenses
Non-Bankruptcy

• Other Impacts on the Negotiated Sale
  – Focus on liabilities
  – Getting value to owners
  – Indemnities
  – Price terms, including escrows/holdbacks and earnouts
  – Process

• Risk of Bankruptcy Filing Post-Sale
  – Incentives to avoid bankruptcy/handle fraudulent transfer claims
Non-Bankruptcy

• Other Non-Bankruptcy Sale Alternatives
  – Foreclosure Sale: extinguish liens but liability risks
  – Receivership/Assignment for Benefit of Creditors
    • Limited “free & clear”
  – Combined Private Sale & Subsequent Liquidation
    • Notice from Assignee
    • Notice of Voluntary Dissolution
III. Distressed Company M&A in Bankruptcy
Bankruptcy

• Overview

• Sale through a Bankruptcy
  – Creditor “stay” to help stabilize the Target
  – Facilitate transfer of key contracts/leases
  – Sell without creditor (or equity) consent
  – Ability to cherrypick assets to buy
  – Other:
    • “Conflict” sales: Sales to insiders, parties wearing multiple hats
    • Management bonuses pre-filing
Bankruptcy

• Sale Methods
  – (Slower) sale under a “plan of reorganization”
    • Longer Process
    • Chance for some exclusivity
    • Must resolve creditor fights before sell
  – (Quicker) “363” asset sale
    • Most common method employed in bankruptcy cases
Bankruptcy

363 Sale Timeline Example with a “Stalking Horse”

<table>
<thead>
<tr>
<th>Period</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>30-60 Days Pre-Filing</td>
<td>Stalking Horse Buyer lined up after a marketing process</td>
</tr>
<tr>
<td>1-5 Days Pre-Filing</td>
<td>Conditional APA signed with proposed sale process terms</td>
</tr>
<tr>
<td>Filing</td>
<td>Chapter 11 bankruptcy filing</td>
</tr>
<tr>
<td>Next 20-30 Days</td>
<td>Court hearing and orders on APA, sale process terms and related matters</td>
</tr>
<tr>
<td>Next 30-60 Days</td>
<td>Continued marketing to find other qualified bidders</td>
</tr>
<tr>
<td>Next 10-15 Days</td>
<td>Public auction for qualified bidders to determine “highest and best” bid(s)</td>
</tr>
<tr>
<td></td>
<td>- Often apples vs. oranges bids</td>
</tr>
<tr>
<td></td>
<td>- May include creditors credit bidding</td>
</tr>
<tr>
<td>Next 1-5 Days</td>
<td>Court hearing and sale order</td>
</tr>
<tr>
<td>Next 1 to 15 Days</td>
<td>Closing</td>
</tr>
</tbody>
</table>
Bankruptcy

• Stalking Horse Buyer in a 363 sale
  – Commitment to buy at a floor price
  – No real exclusivity only some process protections
  – At auction, Stalking Horse Buyer can increase its bid over its floor
  – Stalking Horse Buyer protections if overbid at auction
    • Including a fee of 2% to 4% and/or (partial) expense reimbursement
  – Advantages/disadvantages for being the Stalking Horse Buyer
  – Impact of credit bids
Bankruptcy

• Impact on Successful Bidder in a 363 Sale
  – Negatives:
    • Typically no indemnities or holdbacks/escrows
    • Typically no earnouts or non-cash consideration
    • Need to address cure costs on assumed contracts/leases
  – Positives:
    • Court order on free and clear transfer of assets
    • No fraudulent transfer risks
    • Unassumed liabilities: Not a Buyer concern (limited exceptions)
Bankruptcy

• Other Key Impacts/ Strategies for Buyers
  – Post close bankruptcy continues
    • Transition Services
    • Access to Records
  – Preference Claim Waivers
  – New: Reps and Warranty Insurance
IV. Comparison
## Process & Deal Terms

<table>
<thead>
<tr>
<th>Matter</th>
<th>Non-Bankruptcy Sale</th>
<th>Bankruptcy-363 Sale</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Target and Buyer Control Over Process</strong></td>
<td>Substantial (subject to potentially reaching accommodations with creditors)</td>
<td>Limited (dictated by the Court with substantial input from creditors)</td>
</tr>
<tr>
<td><strong>Buyer Deal Exclusivity</strong></td>
<td>Common to grant Buyer exclusivity</td>
<td>None (or very limited for Stalking Horse)</td>
</tr>
<tr>
<td><strong>Public Deal Process</strong></td>
<td>Private or semi-private</td>
<td>Very public</td>
</tr>
<tr>
<td><strong>Timetable to Closing</strong></td>
<td>Varies but can be very fast</td>
<td>Typically months</td>
</tr>
<tr>
<td><strong>“Stalking Horse” Buyer</strong></td>
<td>Not used</td>
<td>Very common (may be Overbid anytime)</td>
</tr>
<tr>
<td><strong>Reps and Indemnities for Benefit of Buyer</strong></td>
<td>Possible (but Owners may have no incentive to provide)</td>
<td>-May be some reps pre-closing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>-Typically no reps survive closing</td>
</tr>
<tr>
<td><strong>Escrows/Holdbacks and Earnouts</strong></td>
<td>Possible (but disfavored by creditors)</td>
<td>Typically none (highest and best bid)</td>
</tr>
<tr>
<td><strong>Due Diligence Importance</strong></td>
<td>Very important to critical</td>
<td>Critical (and often constrained other than for Stalking Horse Buyer)</td>
</tr>
</tbody>
</table>

Legend:
- **Positive**
- **Neutral**
- **Negative**
# Protections & Results

<table>
<thead>
<tr>
<th>Matter</th>
<th>Non-Bankruptcy Sale</th>
<th>Bankruptcy-363 Sale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creditor Stay Pre-Closing</td>
<td>None</td>
<td>Yes (which can be critical to keeping the business alive until closing)</td>
</tr>
<tr>
<td>Third Party Consents to Assign Desired Contracts</td>
<td>Required if anti-assignment or change of control clauses</td>
<td>Limited rights of contract parties to object if cure amounts addressed</td>
</tr>
<tr>
<td>Equity Deal-Buyer Exposure for Unpaid</td>
<td>Full exposure to all creditors, so requires creditor accommodations pre-closing</td>
<td>363 usually involves asset sales</td>
</tr>
<tr>
<td>Asset Deal-Creditor Priorities &amp; Payments</td>
<td>Often requires Buyer involvement</td>
<td>Not a Buyer concern (Court process determines distributions post-closing)</td>
</tr>
<tr>
<td>Asset Deal-Buyer Exposure for Unpaid</td>
<td>Risks of fraudulent transfer claims post-closing (if no accommodation pre-closing)</td>
<td>None (with limited exceptions)</td>
</tr>
<tr>
<td>Buyer Certainty on Getting Clear Title</td>
<td>Risks of fraudulent transfer claims post-closing (if no accommodation pre-closing)</td>
<td>Full with Court order approving the sale free and clear</td>
</tr>
</tbody>
</table>

**Legend**

- **Positive**
- **Neutral**
- **Negative**
Presenters

James Baillie
jbaillie@fredlaw.com
612.492.7013

Clint Cutler
ccutler@fredlaw.com
612.492.7070

Ryan Murphy
rmurphy@fredlaw.com
612.492.7310

Simon Root
sroot@fredlaw.com
612.492.7105