

Dealing with Financial Distress: Strategies for Acquiring Distressed Assets and Protecting Contractual Relationships

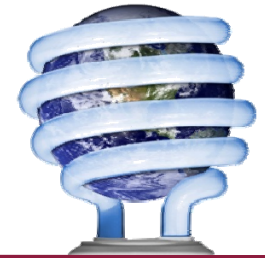
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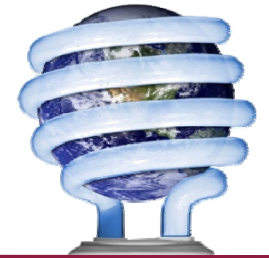
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Presentation Overview

- In the present economic environment all businesses will encounter entities with varying degrees of financial distress
- Those that understand the risks and applicable bankruptcy principles will be best prepared to minimize losses – this is particularly true as applied to contractual relationships
- Financial distress can also create substantial business opportunity

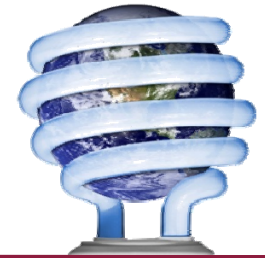


- Focus of Presentation

- How does bankruptcy affect contractual relationships - - strategies to protect your interest when dealing with a distressed counterparty
- Acquiring distressed assets - - understanding the risks and the process of acquiring assets both before and within a bankruptcy case

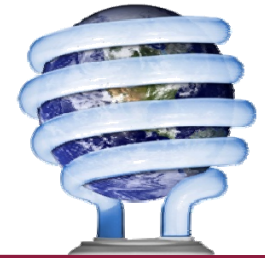


Protecting Contractual Relationships in An Environment of Financial Distress



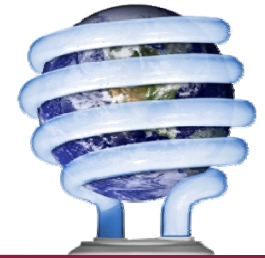
Bankruptcy Basics

- The automatic stay – impact on enforcement of contract rights.
- Rules Governing Executory Contracts and Unexpired Leases
 - What is an executory contract?
 - No statutory definition
 - Generally, any contract with material performance remaining by both parties is executory
 - What is an “Unexpired” lease?
 - Non-enforceability of “Ipso Facto” provisions



Assumption and Rejection

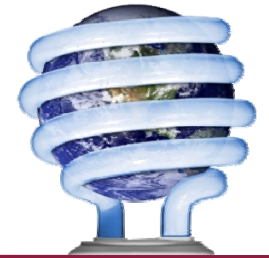
- Assumption: The process by which the debtor's estate agrees to be bound by the contract or lease
 - Contract or lease must be assumed in its entirety
 - No cherry picking
 - Multiple documents as a single contract
 - Single document as multiple contracts



Assumption and Rejection (cont'd)

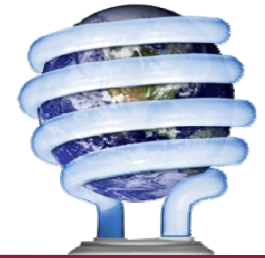
– Assumption Requirements:

- Governing standard is debtor's business judgment
 - Cure defaults
 - Monetary defaults
 - Non-monetary defaults
 - Compensate for pecuniary loss resulting from defaults
 - Provide adequate assurance of future performance
- Non-assumable contracts



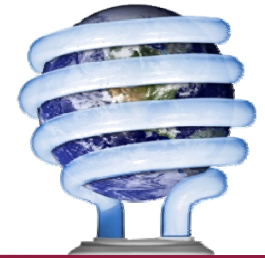
Rejection

- Considered a prepetition breach – converts obligation to perform into dischargeable claim
- Rejecting a previously assumed executory contract or lease
 - Resulting claim for damages entitled to administrative priority
 - Statutory cap on administrative priority imposed by BAPCPA



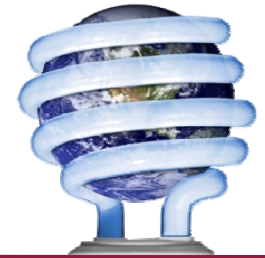
Assignment of Executory Contracts and Unexpired Leases

- Bankruptcy Code overrides non-assignment clause
- The process of assumption and assignment
 - Who cures defaults?
 - Adequate assurance of future performance by assignee
- Non-assignable contracts



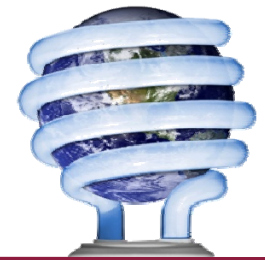
Timing for Debtor's Assumption and Rejection

- Executory contracts generally
- Non-Residential real property leases
 - debtor as lessee
 - debtor as lessor
- Equipment leases



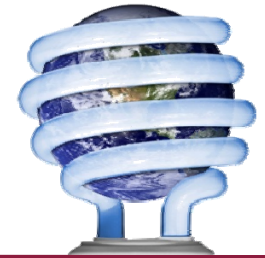
Performance Pending Assumption or Rejection

- Non-debtor may be required to perform continuing obligations
- Need to document debtor's request for continuing performance
 - Right to administrative priority or other assurance of payment
- Limited ability to compel assumption or rejection prior to deadline



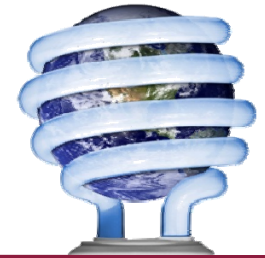
Protected Contracts Under the Code

- What is a “Protected” Contract – Forward Contracts
- Are you a “forward contract merchant” or “financial participant?”
- Benefits of Protected Contract Status
 - Termination based on bankruptcy filing
 - Ability to terminate, close out, net, and apply collateral
 - Protection from preference and constructive fraudulent transfer claims



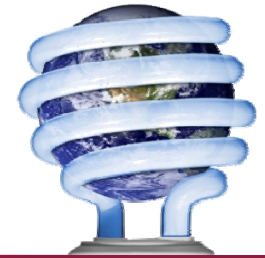
Certain Energy Related Issues

- Treatment of Oil and Gas Leases
 - Unexpired lease or interest in land?
 - Rejection of oil and gas lease by debtor lessor
 - Lessee right to continuing possession
- Oil and gas purchase and/or supply agreements as protected contracts



Strategies for Protecting Contractual Rights

- Pre Bankruptcy Issues and Strategies
 - Ability to structure relationship as protected contract
 - Managing preference exposure
 - What is a preference?
 - Managing credit exposure to control preference exposure
 - New value defense to preference claims
 - Ordinary Course of business defense



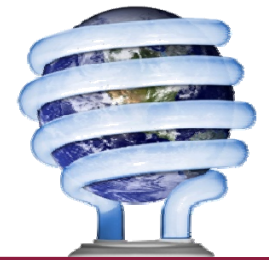
Post Bankruptcy Issues and Strategies

- Identify and understand your contractual relationships and the rules governing them
- Take steps to ensure will be paid for pre-assumption/
rejection performance
 - Do not volunteer performance; document debtor's request for performance as necessary to benefit estate
 - Do not continue performing if debtor breaches post-bankruptcy



Post Bankruptcy Issues and Strategies (cont'd)

- Assess ability to compel early assumption or rejection
- Be prepared to document prepetition defaults and any pecuniary damage caused by such defaults
 - Protective proof of claim
- Monitor bankruptcy case and applicable assumption or rejection deadline



Acquiring Distressed Assets



Acquiring Assets Outside of Bankruptcy

- The Risk: Subsequent attack as fraudulent transfer
- The Buyers Conundrum: The lower the price, the greater the risk

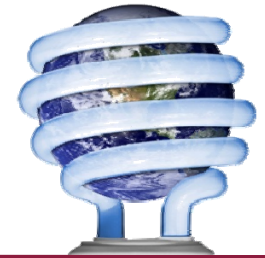


Steps to reduce, but not eliminate, risk

- Financial Condition of Seller
 - No Safe Harbor
 - Can you get a solvency certificate?
 - Can you get a solvency representation?
- Fairness or “Reasonable Equivalence” of Purchase Price
 - No Safe Harbor
 - Requiring Seller to get a fairness opinion
 - Representations with regard to nature of sale process and resulting fairness of purchase price
 - Enhanced scrutiny and risk of related party transactions



Acquiring Assets From a Chapter 11 Debtor



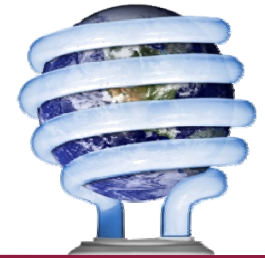
Three Ways To Acquire Assets During A Pending Chapter 11 Bankruptcy Case

- acquiring assets sold in the ordinary course of the debtor's business
- acquiring assets sold outside the ordinary course of the debtor's business – the “363 Sale”
- Acquiring assets sold pursuant to a confirmed plan of reorganization



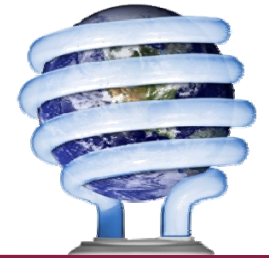
Sales Pursuant to Section 363 of the Bankruptcy Code

- Principal Advantages
 - Acquire assets “free and clear” of third party interests
 - Obtain assignment of executory contracts and leases without non-debtor consent
 - Eliminates fraudulent transfer risk
 - Ability of good faith purchaser to moot appeal of sale approval order



“Free and Clear” Sales Under The Bankruptcy Code

- Code allows sales of property “free and clear of any interest in such property”
- Right is not unlimited - One of following requirements must be met:
 - Applicable nonbankruptcy law permits sale of such property free and clear of such interest
 - The entity claiming the interest consents to the sale free and clear of its claimed interest



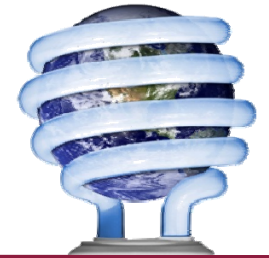
“Free and Clear” Requirements (cont’d)

- The claimed interest is a lien and the price to be obtained for the property exceeds the aggregate value of all liens asserted against the property
- The claimed interest is in bona fide dispute
- The entity claiming the interest can be compelled in a legal or equitable proceeding to accept a money satisfaction of such interest



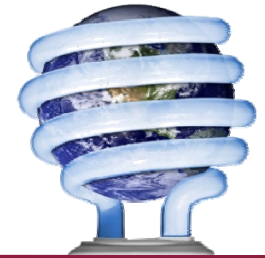
Scope of Free and Clear Sale Order

- Common Misconception:
 - Code doesn't authorize sales free and clear of claims
 - Liability imposed by law: The risk of successor liability
 - Most sale orders provide sales are “free and clear of liens, claims and encumbrances of any kind or nature: - - Why?”
 - Sales Order Cannot Be Collaterally Attacked



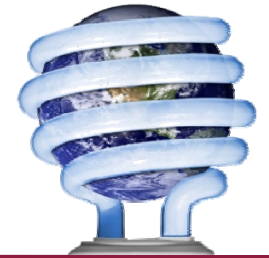
Broad Notice is Critical: Final Sale Order is Binding on All Creditors That Received Notice of Sale

- Final order binding even if Court lacked power to enter order in first instance
- Buyer should require notice of sale be given to all known parties
- Consider publication if concerned about unknown creditors



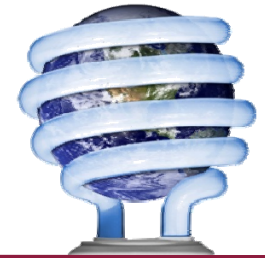
To Be Successful – You Must Understand the Bankruptcy Sale Process

- Section 363 sales are subject to Court Approval
- Approval Standard: sound business judgment and in the best interest of the estate
 - Highest and Best Price Available
 - Assets Effectively Marketed
 - Competitive Bidding



The Stalking Horse Bidder

- Benefits:
 - Shape sales contract; potentially require other bidders to bid based on your form of contract
 - Ability to negotiate for and receive bid protection
 - Expense Reimbursement
 - Break-Up Fee
 - Careful! Break-up Fee Must Be Approved at Beginning of Sale Approval Process



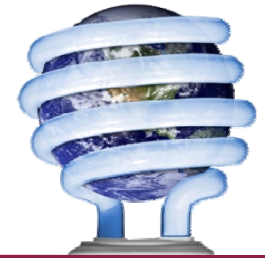
Benefits (cont'd)

- Greater Control Over Bid Procedures and Bid Procedure Order
 - Key Elements:
 - Minimum over bid and bidding increments
 - Establish agreed deposit and related provisions
 - Establish stalking horse right to “Credit bid” break-up fee
 - Establish mechanism for valuing non-cash consideration
 - Establish whether piecemeal bids are permitted
 - Establish standard for valuing and comparing bids
 - Establish extent to whether debtor can bind losing bid as “back up” bid



Possible Disadvantages of Becoming Stalking Horse Bidder

- Risk of over-pricing assets
- Potentially allows other bidders to use stalking horse due diligence efforts
- Approve bid protection



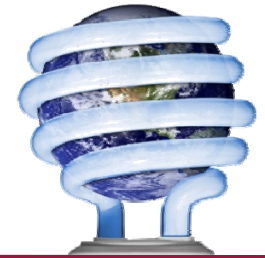
The Sales Approval Process

- Two Step Process:
 - Step One: Motion To Approve Bid Procedures, including Stalking Horse Bid Protection
 - Establish bidding deadlines
 - Establish hearing dates



–Step Two: Motion To Approve Sale

- Includes Proposed Sale Order
- Includes Process for Assumption and Assignment of Executory Contracts
- Time Table



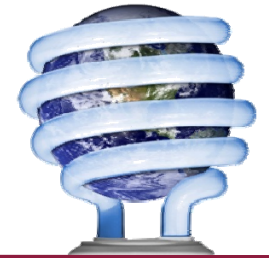
Negotiating the Sale Approval Order

- Free and Clear language
- Factual Findings
 - Scope and propriety of notice
 - Fair value
 - Good faith purchaser status
 - Executory contract assumption and assignment procedures
 - Free and clear support
 - buyer not a successor



Negotiating the Purchase Agreement

- In most respects, a typical “corporate” transaction
- Provisions driven by bankruptcy or seller distress
 - Limited value of representations and warranties
 - Will debtor/seller survive?
 - Alternatives
 - Executory contract assumption/assignment provisions
 - Who pays cure amounts?
 - Commitments re provision of adequate assurance



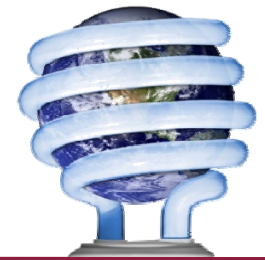
Negotiating the Purchase Agreement (cont'd)

- Termination rights and relationship to bid protection payments
- Require buyer concurrence to form of sale order
- Right to compel closing in face of appeal to sale order
- Role of the Creditors' Committee



Sales Under Chapter 11 Plans

- Potential Benefits:
 - May not require competitive bidding process
 - Transfer tax exemption



- Risks

- Timing and lack of control

- Plan process longer than 363 sale process

- Focus of plan is on factors that often have nothing to do with proposed sale

- Process delayed/derailed by matters unrelated to sale