

# DISRUPTIVE ENGAGEMENT: THE ROLE OF CREDITORS IN ASSET SALES

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# Presenters

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# Case Study

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- XYZ, a widget maker with assets and operations in New York and California, is struggling.
- After exploring a variety of restructuring options, XYZ decides to commence a chapter 11 case and pursue a section 363 sale of its operating assets.
- On the petition date, its outstanding secured indebtedness totals approximately \$500 million and is comprised of:
  - first lien indebtedness under an ABL;
  - secured term loan; and
  - second lien floating rate notes (*i.e.*, second lien on PP&E and third lien on working capital assets).
- XYZ's unsecured indebtedness totals \$600 million and includes high yield bonds. XYZ has no significant unencumbered assets.
- XYZ requires DIP financing to support its operational and liquidity needs while it pursues a section 363 sale.

# DIP Financing

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- Who is providing the DIP financing (*i.e.*, a new lender, a prepetition lender (possibly in connection with a credit bid) or a third party purchaser)?
  - Does the prepetition intercreditor agreement impose limitations with respect to who can provide DIP financing (or the amount and terms of such financing)?
- Purpose of the financing – is it necessary or just a means to an end for the purchaser?
- Milestones – driven by liquidity, restructuring support agreement, etc.
- Limit credit bidding (if appropriate).
  - Liens on all of the assets being sold?
  - “Cause” exist to limit credit bidding?
- Preserve value for unsecured creditors.
  - Carve out avoidance actions from liens granted to DIP Lender and any adequate protection liens; other unencumbered assets?
  - Reserve right to require marshaling of assets.
  - Limit reimbursement of fees and expenses under the DIP financing agreement (or as adequate protection) – for lenders bidding on assets, exclude expenses related to the sale transaction.

# DIP Financing (and Adequate Protection) (continued)

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➤ Other considerations:

- Pursuit, timing and funding of investigations and challenges to perfection of collateral by the Official Committee of Unsecured Creditors (the “Committee”) as well as claims against officers and directors (breach of fiduciary duty, etc.) and lenders (fraudulent/preferential transfers).
  - Committee standing motion?
- Use of Rule 2004 examinations to obtain information about property, liabilities and financial condition of the debtors.
- Committee not yet formed? Review DIP financing agreement and proposed approval order to ensure rights of general unsecured creditors not negatively impacted.
- Budget:
  - Line items to pay ordinary course general unsecured vendor claims on a going forward basis.
  - Line item for Committee professional fees in an amount that makes sense – *i.e.*, sufficient so that DIP does not control/limit ability of Committee professionals to adequately represent general unsecured creditors.

# Bidding Procedures and Sale Process

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- True sale? Should it proceed through a plan?
- Timeline for sale: Extension appropriate? Extent of prepetition marketing efforts?
- Qualified bidder requirements and stalking horse bidder protections:
  - If the proposed purchaser is the DIP Lender or an insider, consider whether milestones and qualified bidder requirements are designed to chill bidding.
  - If the DIP Lender is the stalking horse bidder, should a court assess its proposed breakup fee/expense reimbursement on a stand-alone basis or should it factor in protections provided to the DIP Lender under the DIP approval order?
- Backup bidder?
- Who attends auction?
- Is the sum of the parts greater than the whole? Would a piecemeal sale be better than a sale of the business as whole?

# Bidding Procedures and Sale Process (continued)

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- If prepetition lenders/creditors intend to credit bid, consider:
  - lien challenge;
  - whether a basis exists to equitably subordinate and/or recharacterize the secured lenders'/creditors' claims; and/or
  - whether cause exists to limit or cap their credit bid(s).
- Landlord issues: Administrative rent; cure.
- Other contract issues? Intellectual property, employee, etc.?
- Intercreditor agreement issues.

# Sale

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- Valuation and/or allocation disputes.
- Did lenders credit bid?
  - If credit bid includes the DIP, is it fully drawn?
  - Are DIP Lenders (when purchasers) purchasing debtor's assets with its own funds?
- Ensure sale provisions protect the rights of creditors with reclamation/consignment claims that may have priority over some or all of lender claims.
- Who pays cure claims?
- Retain v. transfer preference claims against vendors.
- Are employees being transferred to purchaser? If so, who pays their claims?
- Disguised reorganization without requisite disclosure under section 1129?
- Does the deal favor insiders?

# Other Considerations

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- How organized/engaged were creditors prepetition?
- Did the company meaningfully engage with (and obtain the support of) key stakeholders before the filing?

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