AMERICAN BANKRUPTCY INSTITUTE

New York City Bankruptcy Conference 2021

Post-Restructuring

Paul H. Zumbro, Moderator
Cravath, Swaine & Moore LLP

Hon. James L. Garrity
U.S. Bankruptcy Court (S.D.N.Y.)

Kristopher M. Hansen
Stroock & Stroock & Lavan LLP

William H. Henrich
Getzler Henrich & Associates LLC

Brett H. Miller
Willkie Farr & Gallagher LLP

Steven A. Seiden
Seiden Krieger Associates, Inc.

CONCURRENT SESSION

2021

ABI's 2021 NYC Bankruptcy Conference

ABI Post-Restructuring Panel

Additional Materials

May 20, 2021

TAB	DOCUMENT
1	*Barry's Jewelers, Inc., Securities and Exchange Commission No-Action Letter*
2	*Building Boards for Companies in Bankruptcy*
3	*Lessons on Creating or Rebuilding a Board*
4	*Bankruptcy Articles – Assembling a Board Post-Bankruptcy*
5	*Recruiting Post-Bankruptcy Board Directors in the Pandemic Aftermath*
6	*In re Sanchez Energy Corporation – Excerpt from Second Amended Joint Plan of Reorganization*
7	*In re Piece Goods Shops Co., L.P.*
8	*DOJ Clears Co-Op's $443M Buy From Bankrupt Dean Foods*
9	*NYSE and NASDAQ – Bankruptcy and Delisting*
10	*Investors Mount Competing Bids to Buy Hertz Out of Bankruptcy*
11	*Acquisitions of Firms in Bankruptcy Are Subject to the Antitrust Laws*

Cheetah™

Wolters Kluwer

SEC No-Action Letters, Barry's Jewlers, Inc., Securities and Exchange Commission, (Jul. 20, 1998)

SEC No-Action Letters
WSB File No. 080398003

Click to open document in a browser

Barry's Jewlers, Inc.

Public Availability Date: July 20, 1998

WSB File No. 080398003

Fiche Locator No. 2938E13

WSB Subject Categories: 46, 106

References:

Securities Exchange Act of 1934, Section 4(2)

________________Washington Service Bureau Summary________________

Headnote

"...The staff will not recommend Commission action, in reliance on counsel's opinion that the exemption from registration provided by U.S. Bankruptcy Code section 1145(a) is available, if this company (debtor) and the debtor from and after the effective date of the reincorporation merger (reorganized debtor) effect a reincorporation to Delaware by means of a merger without 1933 Act registration. The staff also will not recommend Commission action, in reliance on counsel's opinion that the exemption from Bankruptcy Code section 1145(a)(1)(B) or 1145(a)(2) is available, if the debtor issues purchase rights inherent in the bondholder contribution and the reorganized debtor issues its new common shares to persons other than DDJ Capital Management, LLC and Mitchell Hutchins Asset Management, Inc. pursuant to the plan of reorganization without 1933 Act registration. On May 11, 1997, the debtor filed a voluntary petition for reorganization under Chapter 11 and has continued as a debtor-in-possession pursuant to the Bankruptcy Code sections 1107 and 1108. The following committees have been formed in connection with the Chapter 11 proceedings: 1) the official bondholders committee; 2) the official committee of unsecured creditors, and 3) an unofficial committee of equity interest holders. On April 7, 1998, an agreement regarding consensual plan of reorganization was entered into among the debtor, the bondholder's committee, DDJ Capital, Mitchell Hutchins, the creditors' committee, the equity committee, BankBoston, N.A. (BankBoston), CIT Group Business Credit, Inc. (CIT), Jackson Nat'l. Life Insurance Co. (Jackson) and Long Horizon Fund, L.P. (collectively with BankBoston, CIT and Jackson, the bank group). The agreement provides that: 1) each member of the bank group will receive 100% of its share of the bank group's allowed secured claim; 2) each general unsecured creditor of the debtor generally will receive a pro rata distribution of $2.55 million provided allowed claims equal or exceed $17 million; 3) each holder of the debtor's 11% senior secured notes (bondholders) will receive a pro rata distribution of 50% of the new common shares to be issued after the debtor's old common shares are canceled, and 4) each existing shareholder of the debtor will receive its pro rata distribution of warrants to purchase five percent of the new common shares. The agreement also provides that: 1) each bondholder, other than DDJ Capital and Mitchell Hutchins, will be entitled to contribute its pro rata share of $15 million in cash in exchange for its pro rata share of 45% of the new common shares (bondholder contribution), and 2) each of DDJ Capital and Mitchell Hutchins have agreed to contribute on a pro rata basis an amount equal to $15 million in cash minus any amounts contributed by other bondholders pursuant to the bondholder contribution, in exchange for its pro rata share of that amount of new common shares equal to 45% of the new common shares less the bondholder contribution of new common shares. The staff states that new common shares issued to persons other than DDJ Capital and Mitchell Hutchins may be resold without registration by any such person who is neither an underwriter within the meaning of section 1145(b)(1) nor an affiliate of the reorganized debtor. The staff states that persons described in section 1145(b)(1) and affiliates of the reorganized debtor may effect resales under an effective 1933 Act registration statement, rule 144 (not including the holding period condition applicable only to restricted securities) or another exemption from registration. The staff, while disagreeing with counsel's analysis, concurs with counsel's conclusion that the transactions to be effected in reliance on section 1145(a) of the Bankruptcy Code should not be integrated with offers and sales to DDJ Capital and Mitchell Hutchins. The staff expresses no other views concerning the validity of the exemptive claim under 1933 Act section 4(2) as to such offers and sales. "

[INQUIRY LETTER]

May 8, 1998

Securities and Exchange Commission

Division of Corporation Finance

Office of the Chief Counsel

450 Fifth Street, N.W.

Washington, D.C. 20549

Re: **Barry's Jewelers, Inc.**

Ladies and Gentlemen:

We are special corporate counsel to Barry's Jewelers, Inc., a California corporation (the "Debtor ") that is currently operating as a debtor-in-possession under Chapter 11 of the Bankruptcy Reform Act of 1978, as amended and codified at title 11 of the United States Code (the "Bankruptcy Code "). On behalf of the Debtor we request that the staff (the "Staff ") of the Division of Corporation Finance (the "Division ") of the Securities and Exchange Commission (the "Commission ") advise us:

(1) that no enforcement action will be recommended to the Commission if:

(a) the Reincorporation Merger (as such term is defined below) is consummated with the successor thereunder (i.e., the Reorganized Debtor (as such term is defined below)) constituting the successor to the Debtor within the meaning of Section 1145(a)(1) ("Section 1145(a)(1) ") of the Bankruptcy Code;

(b) the Debtor issues the "purchase rights " inherent in the Bondholder Contribution Election Procedure (as such term is defined below and to the extent such "purchase rights " constitute a separate security under the Securities Act (as such term is defined below)), and following the effectiveness of the Reincorporation Merger the Reorganized Debtor issues the Bondholder Contribution New Common Stock and all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (as all such terms are defined below), in each case without registration under the Securities Act of 1933, as amended (the "Securities Act "), in reliance on (i) with respect to such "purchase rights, " Section 1145(a)(1)(B) of the Bankruptcy Code ("Section 1145(a)(1)(B) "), (ii) with respect to the Bondholder Contribution New Common Stock, Section 1145(a)(1)(B) or Section 1145(a)(2) of the Bankruptcy Code ("Section 1145(a)(2) "), and (iii) with respect to all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization, Section 1145(a)(1)(B); and

(c) resales of the Bondholder Contribution New Common Stock and all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization, the New Warrants (as such term is defined below) and all New Common Stock issuable upon exercise of the New Warrants are effected without registration under the Securities Act so long as the selling security holders are not underwriters within the meaning of Section 1145(b)(1) of the Bankruptcy Code or "affiliates " of the Reorganized Debtor within the meaning of the Securities Act, and that selling security holders that are such "affiliates " may effect such resales pursuant to Rule 144 under the Securities Act (except for the holding period requirement), registration under the Securities Act or another available exemption therefrom; and

(2) that, under our view that, characterized as a separate transaction or transactions, the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock (as such term is defined below)) is exempt from registration under the Securities Act by Section 4(2) thereof ("Section 4(2) "), the Staff will not conclude that such issuance under Section 4(2) should be integrated with the issuance of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock to Bondholders other than DDJ Capital and Mitchell Hutchins and all other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization in reliance on Section 1145(a)(1)(B) and/or Section 1145(a)(2) so as to render Section 4(2) unavailable with respect to the former issuance, or so as to render Section 1145(a)(1)(B) and/or Section 1145(a)(2) unavailable with respect to the latter issuances.

Factual background

Business

The Debtor is a large specialty retailer of fine jewelry in the United States. Prior to the Petition Date (as such term is defined below), the Debtor operated 163 retail jewelry stores in 18 states. The Debtor presently operates 118 retail jewelry stores in 17 states.

Chapter 11 proceedings

On May 11, 1997 (the "Petition Date "), the Debtor filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Central District of California (the "Bankruptcy Court "), which proceedings (the "Chapter 11 Proceedings ") are being administered under Case No. LA 97-27988 VZ. Since the Petition Date, the Debtor has continued to operate its business as a debtor-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code. The following official committees have been appointed in the Chapter 11 Proceedings: (1) the Official Committee of Bondholders (the "Bondholders' Committee ") and (2) the Official Committee of Unsecured Creditors (the "Creditors' Committee "). Additionally, an unofficial committee of equity interest holders has been formed (the "Equity Committee ").

The Debtor has entered into an Agreement Regarding Consensual Plan of Reorganization with certain of its constituents. Such agreement is described below under the caption "--Agreement Regarding Consensual Plan of Reorganization " and sets forth an agreement among the parties thereto with respect to the terms and conditions of a Plan of Reorganization of the Debtor (the "Plan of Reorganization "). The Debtor filed the Plan of Reorganization and the related Disclosure Statement (the "Disclosure Statement ") with the Bankruptcy Court on April 30, 1998 (a copy of each of the Plan of Reorganization and the Disclosure Statement, in each case as so filed, is enclosed herewith for the Staff's reference convenience). [1] The Disclosure Statement must be approved (after notice and hearing) by the Bankruptcy Court under Section 1125(b) of the Bankruptcy Code (which approval will include a determination by the Bankruptcy Court that the Disclosure Statement contains adequate information within the meaning of such section). The Disclosure Statement hearing has been scheduled for July 16, 1998. Following the entry of an order of the Bankruptcy Court approving the Disclosure Statement, the Plan of Reorganization and Disclosure Statement will be distributed to all holders of claims against or interests in the Debtor who are entitled to vote to accept or reject the Plan of Reorganization, for purposes of soliciting such vote. After such vote, the Plan of Reorganization must be confirmed by the Bankruptcy Court before it may be implemented. The Debtor anticipates requesting of the Bankruptcy Court that the confirmation hearing be scheduled for the week of September 7, 1998. Following such confirmation, the Plan of Reorganization will be consummated (the date of such consummation, the "Effective Date "). As used herein, the term "Reorganized

Debtor " means the Debtor from and after the Effective Date (after consummation of the Reincorporation Merger unless the context otherwise requires).

Outstanding securities

The Debtor's existing authorized capitalization consists of 8,000,000 shares of common stock, without par value (the "Old Common Stock "). The Old Common Stock is registered under Section 12(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act "). As of April 30, 1998, there were approximately 4,029,372 shares of Old Common Stock issued and outstanding, which were held of record by approximately 200 holders. At the Petition Date, the Old Common Stock was listed on the Nasdaq National Market under the symbol "BARY. " Following the Petition Date, and as a result of the Debtor's Chapter 11 filing, the National Association of Securities Dealers, Inc. suspended trading in the Old Common Stock on the Nasdaq National Market as of July 11, 1997. There is currently no active market for the Old Common Stock, although the Debtor believes that limited trading of the Old Common Stock occurs in the over-the-counter market in the so-called "pink sheets. "

As of April 30, 1998, the Debtor had outstanding approximately 1,050,000 warrants (the "Old Warrants ") to purchase Old Common Stock and 155,793 options (under employee benefit plans) to purchase Old Common Stock. The Old Warrants are registered under Section 12(g) of the Exchange Act.

On the Petition Date, the Debtor had outstanding $50,000,000 in aggregate principal amount of 11% Senior Secured Notes due December 22, 2000 (the "Senior Notes "). The Senior Notes are not listed on any securities exchange, although limited trading thereof occurred prior to the Petition Date, and thereafter the Debtor believes, in the over-the-counter market.

The Debtor has complied with all periodic reporting obligations under Section 13(a) of the Exchange Act, except that the Debtor filed a Form 12B-25 with respect to its Annual Report on Form 10-K for the fiscal year ended May 31, 1997 and its quarterly report on Form 10-Q for the fiscal quarter ended February 28, 1997. Since such time, the Debtor has continued to timely file its reports under Section 13(a) of the Exchange Act.

Agreement Regarding Consensual Plan of Reorganization

On April 7, 1998, an Agreement Regarding Consensual Plan of Reorganization (the "Plan Agreement "), a copy of which is enclosed herewith for the Staff's reference convenience, was entered into among (1) the Debtor, (2) the Bondholders' Committee, (3) D.D.J. Capital Management, LLC and/or funds managed or controlled thereby (collectively, "DDJ Capital "), (4) Mitchell Hutchins Asset Management, Inc. and/or funds managed or controlled thereby (collectively, "Mitchell Hutchins "), (5) the Creditors' Committee, (6) the Equity Committee, and (7) BankBoston, N.A. ("BankBoston "), The CIT Group/Business Credit, Inc. ("CIT "), Jackson National Life Insurance Company ("Jackson "), and Long Horizon Fund, L.P. ("Long Horizon, " and collectively with BankBoston, CIT, and Jackson, the "Bank Group "), regarding the terms of a consensual plan of reorganization for the Debtor. The Plan Agreement was achieved through months of intense and productive negotiations among the parties thereto (the "Parties ") and their respective financial and legal advisors, and is designed to maximize the value of the Debtor's bankruptcy estate for the benefit of all the Debtor's claims and interest holders. The Bankruptcy Court was apprised of the existence of the Plan Agreement and of certain terms thereof. Under the Plan Agreement, the Parties agreed to support a Plan of Reorganization for the Debtor that includes, inter alia, the terms and conditions described below (which terms and conditions are now additionally set forth in the Plan of Reorganization).

Bank Group. Consistent with the Plan Agreement, the Parties agreed that the Bank Group's allowed secured claim was $57,880,214.01 as of the Petition Date. The Plan Agreement provides that each member of the Bank Group will receive under the Plan of Reorganization one hundred percent of its share of the Bank Group's allowed secured claim in cash on the Effective Date in accordance with the terms of the related prepetition loan documents.

General Unsecured Creditors. The Plan Agreement provides that each general unsecured creditor of the Debtor (individually, a "General Unsecured Creditor " and, collectively, the "General Unsecured Creditors ") generally will receive under the Plan of Reorganization a pro rata distribution of $2.55 million in cash (plus prescribed interest thereon from the Effective Date), provided the allowed claims of the General Unsecured Creditors (individually, an "Allowed General Unsecured Claims " and, collectively, the "Allowed General Unsecured Claims ") equal or exceed $17 million. If Allowed General Unsecured Claims are not at least equal to $17 million, then each General Unsecured Creditor generally will receive an amount equal to fifteen percent of such General Unsecured Creditor's Allowed General Unsecured Claim (plus prescribed interest thereon from the Effective Date).

Bondholders. As contemplated by the Plan Agreement, on the Effective Date, all of the Old Common Stock will be cancelled and it is anticipated that the Reorganized Debtor will issue five million shares of common stock, $0.001 par value per share (the "New Common Stock "). The Plan Agreement provides that each record holder of Senior Notes (individually, a "Bondholder " and, collectively, the "Bondholders ") will receive under the Plan of Reorganization a pro rata distribution of fifty percent of the New Common Stock on a fully diluted basis.

Existing equity. The Plan Agreement provides that each existing shareholder of the Debtor will receive under the Plan of Reorganization its pro rata distribution of warrants (the "New Warrants ") to purchase up to five percent of the New Common Stock on a fully diluted basis. Each New Warrant will entitle the holder thereof to purchase one share of New Common Stock and will be exercisable no later than the fifth anniversary of the Effective Date, at prescribed prices during such five year period. The New Warrants will be transferable and will have such other terms and conditions, not inconsistent with the Plan Agreement, as specified in a warrant agreement to be negotiated. The New Warrants may be called in the event of (1) a sale of all or substantially all of the Reorganized Debtor's assets; (2) a sale of all or substantially all of the Reorganized Debtor's shares; (3) a public offering of common stock of the Reorganized Debtor and/or (4) a merger of the Reorganized Debtor in which the Reorganized Debtor is not the surviving entity (any of such events in clauses (1) through (4), a "Subject Transaction "). The call price will be a prescribed amount of cash and/or securities depending upon whether the market price of the New Common Stock is below or above the exercise price of the New Warrants at the time of the Subject Transaction. The Reorganized Debtor will also have the option to repurchase the New Warrants for a prescribed repurchase price in the event the New Common Stock is listed on a securities exchange or a Nasdaq market and trades at a prescribed premium above the exercise price for a prescribed period.

New capital. Under the Plan Agreement, (1) each Bondholder (other than DDJ Capital and Mitchell Hutchins) will be entitled to contribute (collectively with respect to all such Bondholders, the "Bondholder Contribution "), on the Effective Date, its pro rata share (based upon the allowed amount of each such Bondholder's claim and all Bondholders' claims (including those of DDJ Capital and Mitchell Hutchins)) of $15 million in cash in exchange for its pro rata share of forty-five percent of the New Common Stock (such New Common Stock issued to such Bondholders, the "Bondholder Contribution New Common Stock "), and (2) each of DDJ Capital and Mitchell Hutchins have agreed to contribute (the "DDJ Capital/Mitchell Hutchins Contribution Obligation "), on a pro rata basis (based upon the allowed amount of their respective claims), on the Effective Date, an amount equal to $15 million in cash minus any amounts contributed by other Bondholders pursuant to the Bondholder Contribution, in exchange for its pro rata share of that amount of New Common Stock equal to forty-five percent of the New Common Stock less the Bondholder Contribution New Common Stock (such New Common Stock issued to DDJ Capital and Mitchell Hutchins, the "DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock "). No Bondholder (other than DDJ Capital and Mitchell Hutchins with respect to the DDJ Capital/Mitchell Hutchins Contribution Obligation) will be entitled to participate in more than such Bondholder's pro rata share of the aggregate New Common Stock to be issued pursuant to the Bondholder Contribution and the DDJ Capital/Mitchell Hutchins Contribution Obligation (based upon the allowed amount of each such Bondholder's claim and all Bondholders' claims). The DDJ Capital/Mitchell Hutchins Contribution Obligation is subject only to the absence of a material adverse event with respect to the Debtor's business or assets between the date of execution of the Plan Agreement and the Effective Date, and the obtaining and funding of exit financing reasonably satisfactory to DDJ Capital and Mitchell Hutchins. In this regard, under the Plan Agreement, the Debtor agreed that it would not execute an exit financing commitment letter without the consent of DDJ Capital and Mitchell Hutchins, such consent not to be unreasonably withheld. On April 23, 1998, the Debtor executed an exit financing commitment letter with the consent of DDJ Capital and Mitchell Hutchins (under the Plan

Agreement, (1) DDJ Capital and Mitchell Hutchins may not subsequently object to any term set forth in such commitment letter and (2) their consent thereto will not be deemed approval or acceptance of any terms not included therein).

The Debtor's ability to finalize and effect the Bondholder Contribution with respect to all of the Bondholders (other than DDJ Capital and Mitchell Hutchins), and the DDJ Capital/Mitchell Hutchins Contribution Obligation, in each case on the Effective Date, is material to the Debtor's ability to consummate the Plan of Reorganization. In order to so finalize and effect the Bondholder Contribution, all Bondholders will be required, pursuant to a prescribed procedure (the "Bondholder Contribution Election Procedure "), to elect to participate or not participate therein at the time they vote on the Plan of Reorganization (other than DDJ Capital and Mitchell Hutchins, each of which is already contractually obligated to purchase New Common Stock under the terms set forth in the Plan Agreement pursuant to the DDJ Capital/Mitchell Hutchins Contribution Obligation). The communication of each such Bondholder's decision to elect or not to elect to participate in the Bondholder Contribution will be achieved by means of a separate election therefor to be set forth on an attachment to the ballots distributed in connection with the solicitation of votes on the Plan of Reorganization. Bondholders who fail to indicate any such choice on such attachment, or who fail to return such attachments (with the applicable payment) by the deadline prescribed thereon, will be automatically deemed not to elect to participate in the Bondholder Contribution. Bondholders electing to participate in the Bondholder, Contribution will be required, prior to the Effective Date, to deposit an amount of cash equal to their pro rata share (determined on the basis described above) into an interest-bearing escrow account administered by the Debtor. Such election and deposit will be irrevocable, unless the Effective Date does not occur, in which event all such deposits, with interest received in such account thereon, will be returned to such Bondholders.

Management Grants

The Plan Agreement provides that five percent of the New Common Stock will be reserved for grants (the "Management Grants ") to executive officers of the Reorganized Debtor.

Certain other provisions of the Plan of Reorganization

As part of the consummation of the Plan of Reorganization, the Debtor will be reincorporated as a Delaware corporation by means of merging, on the Effective Date, with and into a Delaware corporation to be formed as a wholly-owned subsidiary of the Debtor solely for such purpose (such merger, the "Reincorporation Merger "). In connection with the Reincorporation Merger, the name of the Reorganized Debtor will be changed to "**Samuels Jewelers, Inc**. " The business purpose of the Reincorporation Merger is to enable the Reorganized Debtor to avail itself of the Delaware corporate law and to effect such name change.

The Debtor intends to register the New Common Stock and the New Warrants under the Exchange Act and to make application for the listing thereof on a national securities exchange or a Nasdaq market.

Discussion and analysis

Section 1145

Section 1145(a)(1) and Section 1145(a)(2) of the Bankruptcy Code provide that:

(a) Except with respect to an entity that is an underwriter as defined in Subsection (b) [of Section 1145], section 5 of the Securities Act of 1933 and any State or local law requiring registration for offer or sale of a security ... do not apply to--

(1) the offer or sale under a plan of a security of the debtor ... or of a successor to the debtor under the plan--

(A) in exchange for a claim against, an interest in, or a claim for an administrative expense in the case concerning, the debtor ... ; or

(B) principally in such exchange and partly for cash or property;

(2) the offer of a security through any warrant, option, right to subscribe, or conversion privilege that was sold in the manner specified in paragraph (1) of this subsection, or the sale of a security upon the exercise of such a warrant, option, right, or privilege.

11 U.S.C. §1145(a)(1)(2).

Successor to the Debtor

The Staff has traditionally taken a flexible approach, consistent with the underlying purposes of the Bankruptcy Code and the interests and protection of investors under the Securities Act, in making determinations as to whether a particular entity or entities constitute a successor or successors to a debtor or debtors within the meaning of Section 1145(a)(1). The Reincorporation Merger should raise no issues in this regard insofar as the sole purpose thereof is to change the state of incorporation of the Debtor to Delaware (and to change the Debtor's name in connection therewith). The assets and liabilities of the Reorganized Debtor immediately after the Reincorporation Merger will be identical to the assets and liabilities of the Reorganized Debtor immediately prior to the Reincorporation Merger. The scope of the nature and type of successors recognized by the Staff as successors for purposes of Section 1145(a)(1) is far broader than that which will result from the Reincorporation Merger. *See*, *e.g.*, *Jet Florida System, Incorporated*, SEC No-Action Letter, 1987 WL 107448, publicly available January 12, 1987 (where, pursuant to a plan of reorganization, a chapter 11 debtor is to merge with and into its wholly-owned subsidiary (also a chapter 11 debtor), such subsidiary to be the survivor thereof and to issue its common stock to unsecured creditors of both such debtors in exchange for such creditors' claims, the Staff took a no-action position with respect to the nonregistration under the Securities Act of such common stock in reliance on Section 1145(a)(1)(A) of the Bankruptcy Code, thereby implicitly determining that such survivor was a successor to the nonsurviving parent debtor within the meaning of Section 1145(a)(1)); *Westmark Systems, Incorporated and Tracor Holdings, Incorporated and Subsidiaries*, SEC No-Action Letter, 1991 WL 270523, publicly available December 13, 1991 (where, pursuant to a plan of reorganization, debtors will organize new corporations and transfer certain assets thereto in order to separate and divide certain of their existing businesses, such transferee corporations will constitute successors for purposes of Section 1145(a)(1)); and In re Amarex, Inc., 53 B.R. 12, 14 (Bankr. W.D. Okla. 1985) (where, pursuant to a plan of reorganization, a reporting company will issue its securities to creditors of a debtor, such debtor to be merged with and into a subsidiary of such reporting company in an acquisition transaction, consistent with the Commission's position, such reporting company constitutes a successor to such debtor within the meaning of Section 1145(a)(1)). Relatedly, the Staff has consistently taken a no-action position with respect to the nonregistration under the Securities Act, in reliance on Rule 145(a)(2) [2] thereof, of the securities of a successor corporation pursuant to a reincorporation merger. *See*, *e.g.*, *MapInfo Corporation*, SEC No-Action Letter, 1997 WL 453770, publicly available August 6, 1997 (Division will not recommend enforcement action to the Commission if an issuer merges with and into its wholly-owned subsidiary to effect a reincorporation from New York to Delaware and the surviving entity's common stock is issued pursuant thereto without registration under the Securities Act in reliance on Rule 145(a)(2) thereof). For these reasons, and consistent with the Staff's prior no-action advice, we request that the Staff advise us that no enforcement action will be recommended to the Commission if the Reincorporation Merger is consummated with the successor thereunder (i.e., the Reorganized Debtor) constituting the successor to the Debtor within the meaning of Section 1145(a)(1).

Section 1145(a)(1)(B) and Section 1145(a)(2)

The Bondholder Contribution Election Procedure is not designed or intended to create a separate security for purposes of federal bankruptcy or securities laws, and the "purchase rights " inherent therein are in any event dissimilar to the typical derivative security issued under Section 1145(a)(1) (such as, for example, transferable, usually certificated, warrants or purchase rights issued under a plan of reorganization on the effective date thereof or a distribution date subsequent thereto). Instead, the Bondholder Contribution Election Procedure is designed to function solely as a mechanism to facilitate the finalization and consummation of the Bondholder Contribution and the issuance of the Bondholder Contribution New Common Stock, in each case on the Effective

Date. As contemplated by the Plan Agreement, and as set forth in the Plan of Reorganization, the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock, the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock and all other New Common Stock to be issued to the Bondholders pursuant to the Plan of Reorganization are to be issued to Bondholders in exchange for such Bondholders' allowed claims and an aggregate of $15 million in cash.

As set forth in the letter of the Debtor's financial advisor, SBC Warburg Dillon Read Inc. (the "SBCWDR Letter "), a copy of which is enclosed herewith (and with respect to which the Debtor hereby requests confidential treatment under 17 C.F.R. §200.83), it is currently estimated that the total enterprise value of the Reorganized Debtor will range between approximately $72 million and $93 million, and that the implied equity value of the Reorganized Debtor will range between approximately $47 million and $68 million. [3] Based on such implied equity value, it is the Debtor's view that the implied value of the allowed claims of Bondholders other than DDJ Capital and Mitchell Hutchins, assuming full participation in the Bondholder Contribution, will range between approximately $13,650,000 and $23,100,000, [4] calculated as follows:

Implied equity value .... $47,000,000 to $68,000,000

Less 10% (representing portion thereof

attributable to New Warrants and

Management Grants) .... 4,700,000 to 6,800,000

Implied equity value attributable to the New

Common Stock to be issued to all

Bondholders .... 42,300,000 to 61,200,000

Implied equity value attributable to the New

Common Stock to be issued to Bondholders

other than DDJ Capital and Mitchell

Hutchins .... 21,150,000 to 30,600,000

Less maximum amount of cash that may be

contributed by Bondholders other than DDJ

Capital and Mitchell Hutchins 7,500,000 7,500,000

Implied value of allowed claims of

Bondholders other than DDJ Capital and

Mitchell Hutchins .... 13,650,000 to 23,100,000

[5]

[6]

[7]

The aggregate consideration to be exchanged by the Bondholders other than DDJ Capital and Mitchell Hutchins for the "purchase rights " inherent in the Bondholder Contribution Election Procedure to be issued thereto (to the extent such "purchase rights " constitute a separate security under the Securities Act) and the New Common Stock to be issued thereto (including the Bondholder Contribution New Common Stock) will therefore range between approximately $21,150,000 and $30,600,000 (determined by adding the implied value of such Bondholders' allowed claims set forth above, plus the maximum $7.5 million in cash that may be contributed thereby pursuant to the Bondholder Contribution). [8] Because the implied value of such Bondholders' allowed claims (i.e., between approximately $13,650,000 and $23,100,000) is greater than the maximum cash component of such consideration (i.e., $7.5 million), it is our view that such issuance is exempt from registration under the Securities Act by virtue of Section 1145(a)(1)(B) (and/or Section 1145(a)(2) with respect to the Bondholder Contribution New Common Stock). Such conclusion is consistent with the Staff's position in several prior no-action letters in which the Staff has granted no-action relief based on Section 1145(a)(1)(B) and/or Section 1145(a)(2) with respect to the nonregistration under the Securities Act of a debtor's or reorganized debtor's securities issued to claim or interest holders in exchange for such holders' claims or interests and other consideration (whether cash, property or a combination thereof), where the implied value of such claims or interests exceeded the value of such other consideration. *See*, *e.g.*, *Gateway Medical Systems, Incorporated*, SEC No-Action Letter, 1987 WL 107453, publicly available January 12, 1987 (Staff granted no-action relief with respect to nonregistration under the Securities Act of a reorganized chapter 11 debtor's successor's common stock to be issued to such debtor's creditors where the value of the claims to be exchanged by such creditors exceeded the value of certain equipment to be contributed by such creditors); *Jet Florida System, Incorporated*, SEC No-Action Letter, 1987 WL 107448, publicly available January 12, 1987 (Staff granted no-action relief with respect to nonregistration under the Securities Act of (1) a reorganized chapter 11 debtor's common stock to be issued to such debtor's unsecured creditors in exchange for such creditors' claims and (2) subscription rights to purchase common stock and common stock issued in connection therewith to be issued to such creditors in exchange for such creditors' claims and cash, where the estimated value of such claims to be exchanged by such creditors exceeded the amount of new cash to be paid by such creditors, such new cash to be paid pursuant to a subscription rights offering to such creditors); and *Bennett Petroleum Corporation*, SEC No-Action Letter, 1983 WL 28907, publicly available December 27, 1983 (Staff granted no-action relief with respect to nonregistration under the Securities Act of a reorganized chapter 11 debtor's preferred stock to be issued to such debtor's common shareholders where the value of the common stock to be exchanged by such shareholders exceeded the amount of new cash to be paid by such shareholders). [9] Such conclusion is also consistent with the Commission's position articulated in several appearances by the Commission as a statutory party in corporate reorganization proceedings under Section 1109(a) of the Bankruptcy Code to the effect that Section 1145(a)(1)(B) is only applicable where a debtor can demonstrate or substantially show that the value of the claims or interests being exchanged exceed the value of the other consideration (whether cash, property or a combination thereof) being exchanged. *See*, *e.g.*, *In re* Marvel Holdings Inc., et al., Debtors, Chapter 11 Case Nos. 96-2066 through 96-2068, and *In re* Marvel Entertainment Group, Inc., et al., Debtors, Chapter 11 Case Nos. 96-2069 through 96-2077, Objection of the Securities and Exchange Commission to the First Amended Disclosure Statement Relating to First Amended Joint Chapter 11 Plan of Reorganization and First Amended Joint Plan filed by Marvel Holdings Inc. ("Holdings ") and The Official Bondholders' Committee of Holdings, Marvel (Parent) Holdings Inc. and Marvel III Holdings, Inc. dated June 13, 1997, 1038 PLI/Corp 51, 229 (where (1) a chapter 11 debtor proposes to issue, to the holders of its old common stock pursuant to its plan of reorganization, for each share of such old common stock, one-half of one share of new common stock and one right to purchase 1.93 shares of new common stock at a purchase price of $1.857576 per share, (2) such rights are to be certificated and transferable and a listing application therefor is to be filed with an exchange, (3) three members of the bondholders' committee will act as standby purchasers with respect to all new common stock not fully subscribed by such stockholders, such issuance not to be registered under the Securities Act in reliance on Section 4(2) and (4) the purpose of such rights offering is to use the net proceeds therefrom to fund such debtor's plan of reorganization (including to pay certain allowed administrative expenses and to refinance or retire such debtor's debtor-in-possession credit facility) and to provide the debtor with working capital, the Commission, favorably citing *Jet Florida Systems, Incorporated*, objected to the applicability of Section 1145(a)(1)(B) and to the plan and the related disclosure statement on the basis that the debtor failed to demonstrate or substantially show that the value of the old common stock to be exchanged under the plan exceeded the amount of the new cash to be contributed pursuant to the rights offering (the implied value of the old common stock being between $1 and $1.25 per share, calculated by reference to the reorganization value of $2 to $2.50 per share of new common stock estimated by the debtor in the disclosure statement)); and *In re* Penn Pacific Corporation, Debtor, Case No. 94-00230, Objection of the Securities and Exchange Commission to Debtor's Application for Determination of Applicability of Bankruptcy Code Section 1145 to Debtor's Second Amended Plan of

Reorganization, 882 PLI/Corp 47, 103 (where (1) plan of Chapter 11 debtor provides that secured creditors, unsecured creditors and holders of old common stock will receive new common stock in exchange for their claims and interests and will be required to contribute $.01 for each share of such new common stock, and (2) disclosure statement states that old common stock has traded on an isolated basis at $1/32 per share, but that such debtor has no assets, the Commission took the position that Section 1145(a)(1)(B) was inapplicable to such new common stock because the debtor had failed to make a substantial showing that the value of the claims and interests being exchanged exceeded the value of the new cash to be contributed for such new common stock). Finally, such conclusion is also consistent with the views of several nationally-recognized reorganization authorities to the effect that an exchange should be exempt from registration under the Securities Act if a claim or interest holder provides the reorganized debtor issuing the securities with consideration comprised of its outstanding claims and/or interests, and cash or other property, and such claims or interests represent more than 50% of such total consideration. [10] Significantly with respect to the Bondholder Contribution, the cash component of the consideration to be exchanged by Bondholders electing to participate therein can never equal or exceed the value of their respective claims included in such consideration, whether viewed on an individual or collective basis, because no such Bondholder can pay more than such Bondholder's pro rata share (determined on the basis described above) of the cash component of such consideration.

The Bondholder Contribution is substantively different from the context in which certain rationales have been suggested for excluding the raising of "fresh capital " from Section 1145(a)(1)(B). One of such rationales would exclude the applicability of Section 1145(a)(1)(B) to third parties that are not claims or interests holders, on the basis that such third parties, unlike claims or interest holders, must decide whether to invest in an issuer (i.e., the debtor) without any prior knowledge of the debtor's business and therefore need the disclosure provided under the federal securities laws. [11] Such reasoning is inapplicable to the Bondholder Contribution because only Bondholders will participate therein. No third parties will be allowed to acquire New Common Stock pursuant to the Bondholder Contribution. Additionally, unlike third-party recipients of "fresh capital securities " who were not "at the table " during reorganization negotiations, the Bondholders have been and will continue to be represented by the Bondholders' Committee (which committee is a signatory to the Plan Agreement).

To the extent the "purchase rights " inherent in the Bondholder Contribution Election Procedure constitute a separate security (and are therefore entitled to exemption from registration under the Securities Act in reliance on Section 1145(a)(1)(B) under the analysis set forth above), the Bondholder Contribution New Common Stock to be issued in connection therewith should be exempt from registration under the Securities Act by virtue of Section 1145(a)(2). Such conclusion is consistent with the Staff's position in several prior no-action letters in which the Staff has granted no-action relief based on Section 1145(a)(2) with respect to the nonregistration under the Securities Act of a reorganized debtor's securities issued upon exercise or conversion of, or in connection with, a derivative security of such debtor issued under Section 1145(a)(1)(A) or Section 1145(a)(1)(B). *See*, *e.g.*, *Jet Florida System, Incorporated* (Staff granted no-action relief with respect to nonregistration under the Securities Act of a reorganized chapter 11 debtor's subscription rights to purchase common stock and the common stock issued in connection therewith to be issued to such debtor's unsecured creditors in exchange for such creditors' claims and cash).

Section 1145(a)(1)(B) achieves the reorganization objective of Chapter 11 of the Bankruptcy Code by permitting a reorganized debtor or a successor thereto to issue its securities without registration under the Securities Act in exchange for a combination of claims and/or interests, and other consideration, so long as the claims and/or interests constitute the principal component of the aggregate consideration. [12] In the absence of Section 1145(a)(1)(B), the successful implementation of many reorganizations simply could not be achieved. Section 1145(a)(2) achieves the reorganization objective of Chapter 11 of the Bankruptcy Code by permitting a reorganized debtor or a successor thereto to issue its securities without registration under the Securities Act upon exercise or conversion of, or in connection with, derivative securities of such debtor or successor issued under Section 1145(a)(1)(A) of the Bankruptcy Code or Section 1145(a)(1)(B). As discussed above, (1) the implied value of the allowed claims of Bondholders other than DDJ Capital and Mitchell Hutchins is greater than the maximum amount of cash that may be exchanged by such Bondholders for the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock and all other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization, and (2) no persons or entities other than such Bondholders, represented by the Bondholders' Committee, will participate in the Bondholders' Contribution. For these reasons, and consistent with the Staff's prior no-action advice, we request that the Staff advise us that no enforcement action will be recommended to the Commission if the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act) are issued by the Debtor, and following the effectiveness of the Reincorporation Merger, the Bondholder Contribution New Common Stock, and all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization is issued by the Reorganized Debtor, in each case without registration under the Securities Act in reliance on (1) with respect to such "purchase rights, " Section 1145(a)(1)(B), (2) with respect to the Bondholder Contribution New Common Stock, Section 1145(a)(1)(B) or Section 1145(a)(2), and (3) with respect to all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization, Section 1145(a)(1)(B).

The Staff has consistently taken a no-action position with respect to the nonregistration under the Securities Act of the resale of securities issued under Section 1145(a)(1)(A) of the Bankruptcy Code, Section 1145(a)(1)(B), or Section 1145(a)(2) (notwithstanding the failure of Section 1145(c) of the Bankruptcy Code to reference Section 1145(a)(2)), so long as the selling security holders are not underwriters within the meaning of Section 1145(b)(1) of the Bankruptcy Code or "affiliates " of the issuer within the meaning of the Securities Act after consummation of the related plan of reorganization. *See*, *e.g.*, *Westmark Systems, Incorporated and Tracor Holdings, Incorporated and Subsidiaries*, SEC No-Action Letter, 1991 WL 270523, publicly available December 13, 1991 (Division took a no-action position with respect to the nonregistration under the Securities Act of the resale of securities issued under Section 1145(a)(1) and Section 1145(a)(2) (including common stock issuable upon exercise of warrants issued under Section 1145(a)(2)), so long as the selling security holders thereof were not "underwriters " within the meaning of Section 1145(b)(1) of the Bankruptcy Code, or "affiliates " of the issuer within the meaning of the Securities Act after the consummation of the plan of reorganization); and *Zenith Laboratories, Incorporated*, SEC No-Action Letter, 1990 WL 285861, publicly available January 12, 1990 (common stock to be issued by a reorganized chapter 11 debtor under Section 1145(a)(2) upon exercise of warrants issued thereby under Section 1145(a)(1) do not constitute "restricted securities " under the Securities Act). Consistent with the Staff's prior no-action advice, we request that the Staff advise us that no enforcement action will be recommended to the Commission if resales of the Bondholder Contribution New Common Stock and all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to to the Plan of Reorganization, the New Warrants and all New Common Stock issuable upon exercise of the New Warrants are effected without registration under the Securities Act so long as the selling security holders are not underwriters within the meaning of Section 1145(b)(1) of the Bankruptcy Code or "affiliates " of the Reorganized Debtor within the meaning of the Securities Act, and that selling security holders that are such "affiliates " may effect such resales pursuant to Rule 144 under the Securities Act [13] (except for the holding period requirement), registration under the Securities Act or another available exemption therefrom.

New Common Stock to be issued to DDJ Capital and Mitchell Hutchins; nonintegration under Section 4(2) analysis

It is our view that, characterized as a separate transaction or transactions, the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock) is exempt from registration under the Securities Act by virtue of Section 4(2). [14] We note that the Commission has not objected to reliance on Section 4(2) in such a context. *See*, *e.g.*, *In re* Marvel Holdings Inc., et al., Debtors, Chapter 11 Case Nos. 96-2066 through 96-2068, and *In re* Marvel Entertainment Group, Inc., et al., Debtors, Chapter 11 Case Nos. 96-2069 through 96-2077, Objection of the Securities and Exchange Commission to the First Amended Disclosure Statement Relating to First Amended Joint Chapter 11 Plan of Reorganization and First Amended Joint Plan filed by Marvel Holdings Inc. and The Official Bondholders' Committee of Holdings, Marvel (Parent) Holdings Inc. and Marvel III Holdings, Inc. dated June 13, 1997, 1038 PLI/Corp 51, 229, footnote 9 (where three members of chapter 11 debtor's bondholders' committee will act as standby purchasers with respect to all new common stock not fully subscribed in a rights offering to holders of old common stock pursuant to such debtor's plan of reorganization, Commission had no objection to reliance by such debtor on Section 4(2) with respect to the nonregistration under the Securities Act of the common stock to be issued to such standby purchasers). We are aware that the Staff as a matter of policy does not issue advice as to the applicability of Section 4(2) with respect to any particular transaction, and we are not requesting any such advice herein, but instead, are requesting advice only as to any integration issue that may arise in connection with the Section 4(2) separate transaction or transactions characterization of the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock).

Under the view that the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock) is exempt from registration under the Securities Act by virtue of Section 4(2), there should be no integration between (1) such issuance and (2) the issuance of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock issued to the Bondholders other than DDJ Capital and Mitchell Hutchins, and all other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization in reliance on Section 1145(a)(1)(B) and/or Section 1145(a)(2). Such conclusion is consistent with the Staff's position in several prior no-action letters in which the Staff has taken or implied a no-action position with respect to the nonintegration of a Section 4(2) private placement and a public offering involving the same securities, both of which are to be consummated at or about the same time. *See*, *e.g.*, *Black Box Incorporated*, SEC No-Action Letter, 1990 WL 286633, publicly available June 26, 1990 (in the context of an issuer's nonbankruptcy restructuring, where a master recapitalization agreement and definitive securities purchase agreements providing for several Section 4(2) private placements of various securities of such issuer (including common stock) would be entered into prior to a registered public offering of common stock of such issuer to be completed as part of and in connection with such restructuring, the Division took the position that such private placements need not be integrated with such later public offering, relying on Rule 152 of the Securities Act ("Rule 152 ") [15] to the effect that the filing of a registration statement subsequent to an offering exempt under Section 4(2) does not vitiate such exemption, and noting specifically that upon the execution of such recapitalization and purchase agreements, the purchasers' obligations thereunder would be subject only to the conditions set forth therein, the satisfaction of which would not be within the control of such purchasers); *Westmark Systems, Incorporated and Tracor Holdings, Incorporated and Subsidiaries*, SEC No-Action Letter, 1991 WL 270523, publicly available December 13, 1991 (where, pursuant to plans of reorganization, chapter 11 debtors' successors are to issue various of their securities (including common stock) to such debtors' claims holders in exchange for such claims, and various of their securities (including common stock) to the nondebtor parent of such debtors in a Section 4(2) private placement, the Division took a no-action position with respect to the nonregistration of such securities to such claims holders under Section 1145(a)(1), thereby implicitly concluding that such private placement should not be integrated with such issuance under Section 1145(a)(1) (the inquiry letter having explicitly requested such a position)); and *MCEN/FPC Joint Venture*, SEC No-Action Letter, 1988 WL 234895, publicly available October 3, 1988 (Division concurred in view that issuance of new common stock by reorganized Chapter 11 debtor to third party in reliance on Section 4(2), the proceeds of which would be used to fund such debtor's plan of reorganization, should not be integrated with the issuance by such debtor under Section 1145(a)(1)(A) of the Bankruptcy Code of new common stock to holders of claims and interests).

With respect to the DDJ Capital/Mitchell Hutchins Contribution Obligation, analogous to the facts in *Black Box Incorporated*, and as discussed above, DDJ Capital and Mitchell Hutchins have already entered into the Plan Agreement, pursuant to which each is obligated to purchase the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock. Such obligations are subject only to the occurrence of the Effective Date and the conditions set forth in the Plan Agreement (i.e., the absence of a material adverse event with respect to the Debtor's business or assets between the date of execution of the Plan Agreement and the Effective Date, and the obtaining and funding of reasonably satisfactory exit financing), the satisfaction of none of which conditions is properly viewed as being within the control of DDJ Capital or Mitchell Hutchins. As described in further detail under the caption "Factual background--Agreement Regarding Consensual Plan of Reorganization--New Capital, " DDJ Capital and Mitchell Hutchins have consented to an exit financing commitment letter executed by the Debtor. The investment decisions of DDJ Capital and Mitchell Hutchins with respect to their purchase of the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock are therefore properly characterized as already having been made (i.e., at the time of their execution of the Plan Agreement). Consequently, as in *Black Box Incorporated*, the issuance to DDJ Capital and Mitchell Hutchins of the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock pursuant to the DDJ Capital/Mitchell Hutchins Contribution Obligation can be viewed as a Section 4(2) private placement that precedes a public offering (under Section 1145(c) of the Bankruptcy Code, the issuance of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock and all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins under the Plan of Reorganization pursuant to Section 1145(a)(1)(B), constitutes a public offering thereof). [16] As such, Rule 152 under the Securities Act should conceptually apply to prevent such private placement from being integrated with such public offering.

In *Westmark Systems, Incorporated and Tracor Holdings, Incorporated and Subsidiaries*, the debtors' parent to be issued securities in the Section 4(2) private placement was intimately involved in its subsidiary debtors' reorganization proceedings (including the negotiation and preparation of the related plans of reorganization) and was additionally a proponent of such plans named in the related disclosure statement. Similarly, each of DDJ Capital and Mitchell Hutchins have been and will continue to be intimately involved in the Debtor's Chapter 11 Proceedings (including the negotiation and preparation of the Plan Agreement and the Plan of Reorganization), both directly and through the representation thereof by the Bondholders' Committee. Each of DDJ Capital and Mitchell Hutchins are signatories to the Plan Agreement.

The no-action position implied by the Division in *Westmark Systems, Incorporated and Tracor Holdings, Incorporated and Subsidiaries* appropriately did not mechanically apply the general five factors that are potentially relevant to an integration analysis. [17] With respect to any particular transaction, such factors should be applied on a case-by-case basis and in context. Under such an evaluation, the purpose of the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital Mitchell/Hutchins Contribution Obligation New Common Stock) is different than the purpose underlying the issuance by the Debtor of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), and the issuance by the Reorganized Debtor of the Bondholder Contribution New Common Stock to Bondholders other than DDJ Capital and Mitchell Hutchins and the other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization. The purpose of the former is, in addition to providing for the Bankruptcy Court-approved resolution of claims of DDJ Capital and Mitchell Hutchins, to provide and ensure that the Reorganized Debtor will have sufficient capital on the Effective Date to successfully consummate the Plan of Reorganization, in the absence of which capital the ability of the Reorganized Debtor to consummate the Plan of Reorganization would be materially and adversely affected. The purpose of the latter is, in addition to providing for the Bankruptcy Court-approved resolution of the claims of Bondholders other than DDJ Capital and Mitchell Hutchins, to provide all such Bondholders with an equal opportunity to elect to participate in the Bondholder Contribution. In addition, the terms of the DDJ Capital/Mitchell Hutchins Contribution Obligation and the Bondholder Contribution are different given that the former is mandatory while the latter is permissive.

In this regard, for purposes of an integration analysis, the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock), and the issuance of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock to Bondholders other than DDJ Capital and Mitchell Hutchins and the other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization, therefore should not be deemed to constitute part of a single plan of "financing. " Although such issuances involve the same class of security, [18] as reflected in the Staff's no-action position in both *Black Box Incorporated* and *Westmark Systems, Incorporated and Tracor Holdings, Incorporated and Subsidiaries*, such fact is not dispositive to the question of integration. Offerings that occur at or about the same time are also not dispositive of such question, again as reflected in the Staff's position in *Black Box Incorporated* and *Westmark Systems, Incorporated and Tracor Holdings, Incorporated and Subsidiaries.* In any event, as discussed above, with respect to the DDJ Capital/Mitchell Hutchins Contribution Obligation, the time of the offering of the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock to DDJ Capital and Mitchell Hutchins pursuant thereto can be properly characterized as occurring prior to the time of the offering of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock to Bondholders other than DDJ Capital and Mitchell Hutchins and the other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization, insofar as the related investment decisions of DDJ Capital and Mitchell Hutchins were made at the time of their execution of the Plan Agreement. Finally, to the extent the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock) is viewed as a separate transaction or transactions, the type and mix of consideration to be paid in connection therewith would be different from that to be exchanged in connection with the issuance of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock to Bondholders other than DDJ Capital and Mitchell Hutchins and the other New Common Stock to be issued to the Bondholders pursuant to the Plan of Reorganization.

The Debtor's ability to bind DDJ Capital and Mitchell Hutchins to effect the DDJ Capital/Mitchell Hutchins Contribution Obligation pursuant to the Plan Agreement is material to the Debtor's ability to consummate the Plan of Reorganization. To the extent the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock) is characterized as a separate transaction or transactions, but integrated with the issuance of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock to Bondholders other than DDJ Capital and Mitchell Hutchins and all other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization in reliance on Section 1145(a)(1)(B) and/or Section 1145(a)(2), such result would require that the Debtor register the New Common Stock under the Securities Act (unless a separate exemption therefrom was available). In the context of the Chapter 11 Proceedings and under the facts set forth herein, such a result would not only be inconsistent with the purposes underlying the Bankruptcy Code and Section 1145 thereof, but moreover, would not serve or advance the disclosure objective of the Securities Act. As described above, the Disclosure Statement will be approved by the Bankruptcy Court (after notice and hearing) as containing adequate information under the Bankruptcy Code and will be distributed to all Bondholders in connection with the Debtor's solicitation of votes with respect to the Plan of Reorganization. No persons or entities other than Bondholders will be issued New Common Stock pursuant to the Bondholder Contribution or the DDJ Capital/Mitchell Hutchins Contribution Obligation. No persons or entities other than Bondholders will be issued the "purchase rights " inherent in the Bondholder Contribution Election Procedure and such "purchase rights " will not be certificated or transferable. Distributing a Securities Act registration statement to Bondholders would be duplicative of the Disclosure

Statement and would not provide Bondholders with any additional material information. Requiring the Debtor to prepare such a registration statement also would impose significant economic expenses on the Debtor and time demands and burdens on the Debtor's management and staff, who are already completely occupied with the preparation of the Plan of Reorganization and Disclosure Statement, and with the administration of the Chapter 11 Proceedings.

For the reasons set forth above, and consistent with the Staff's prior no-action advice and the purposes underlying the Securities Act and the protection of investors, and under our view that, characterized as a separate transaction or transactions, the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock) is exempt from registration under the Securities Act by Section 4(2), we request that the Staff advise us that the Staff will not conclude that such issuance should be integrated with the issuance of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock to Bondholders other than DDJ Capital and Mitchell Hutchins and all other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization in reliance on Section 1145(a)(1)(B) and/or Section 1145(a)(2) so as to render Section 4(2) unavailable with respect to the former issuance, or so as to render Section 1145(a)(1)(B) and/or Section 1145(a)(2) unavailable with respect to the latter issuances.

Conclusion

The Debtor's ability to finalize and effect the Bondholder Contribution with respect to all of the Bondholders (other than DDJ Capital and Mitchell Hutchins), and the DDJ Capital/Mitchell Hutchins Contribution Obligation, in each case on the Effective Date, is material to the Debtor's ability to consummate the Plan of Reorganization. The Debtor and the Debtor's constituencies party to the Plan Agreement view the receipt of a favorable no-action letter from the Staff with respect to the matters herein as critical to confirmation and implementation of the Plan of Reorganization, and the Plan of Reorganization provides that the receipt of such a letter is a condition precedent to the confirmation of the Plan of Reorganization.

Based on the foregoing, on behalf of the Debtor we request that the Staff advise us:

(1) that no enforcement action will be recommended to the Commission if:

(a) the Reincorporation Merger is consummated with the successor thereunder (i.e., the Reorganized Debtor) constituting the successor to the Debtor within the meaning of Section 1145(a)(1);

(b) the Debtor issues the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), and following the effectiveness of the Reincorporation Merger the Reorganized Debtor issues the Bondholder Contribution New Common Stock and all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization, in each case without registration under the Securities Act in reliance on (i) with respect to such "purchase rights, " Section 1145(a)(1)(B), (ii) with respect to the Bondholder Contribution New Common Stock, Section 1145(a)(1)(B) or Section 1145(a)(2), and (iii) with respect to all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization, Section 1145(a)(1)(B); and

(c) resales of the Bondholder Contribution New Common Stock and all other New Common Stock to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization, the New Warrants and all New Common Stock issuable upon exercise of the New Warrants are effected without registration under the Securities Act so long as the selling security holders are not underwriters within the meaning of Section 1145(b)(1) of the Bankruptcy Code or "affiliates " of the Reorganized Debtor within the meaning of the Securities Act, and that selling security holders that are such "affiliates " may effect such resales pursuant to Rule 144 under the Securities Act (except for the holding period requirement), registration under the Securities Act or another available exemption therefrom; and

(2) that, under our view that, characterized as a separate transaction or transactions, the issuance of all New Common Stock to be issued to DDJ Capital and Mitchell Hutchins pursuant to the Plan of Reorganization (including the DDJ Capital/Mitchell Hutchins Contribution Obligation New Common Stock) is exempt from registration under the Securities Act by Section 4(2), the Staff will not conclude that such issuance under Section 4(2) should be integrated with the issuance of the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act), the Bondholder Contribution New Common Stock to Bondholders other than DDJ Capital and Mitchell Hutchins and all other New Common Stock to be issued to such Bondholders pursuant to the Plan of Reorganization in reliance on Section 1145(a)(1)(B) and/or Section 1145(a)(2) so as to render Section 4(2) unavailable with respect to the former issuance, or so as to render Section 1145(a)(1)(B) and/or Section 1145(a)(2) unavailable with respect to the latter issuances.

Should the Staff disagree with, or should any additional information be desired in support of, the views expressed herein, we would appreciate an opportunity to confer with the Staff prior to the issuance by the Staff of any written response hereto. Please direct any questions regarding this request to the undersigned at (713) 546-5198 or Charles Harrell at (713) 546-5107. Pursuant to Securities Act Release No. 33-6269 (December 5, 1980), enclosed herewith are seven copies of this letter. Also enclosed for the Staff's reference convenience are copies of the no-action letters referred to herein. Please acknowledge your receipt of this letter and its enclosures by stamping the enclosed receipt acknowledgment copy hereof and returning such copy to our messenger.

Very truly yours,

Kyle Doda

Weil, Gotshal & Manges LLP

[STAFF LETTER]

July 20, 1998

RESPONSE OF THE OFFICE OF CHIEF COUNSEL

DIVISION OF CORPORATION FINANCE

Re: Barry's Jewelers, Inc.

Incoming letter dated May 8, 1998

Based on the facts presented, the Division's views are as follows. Capitalized terms have the meanings defined in your letter. The Division will not recommend enforcement action to the Commission if, in reliance on your opinion that the exemption from registration under section 1145(a)(1) of the Bankruptcy Code is available, the Debtor and Reorganized Debtor effect the Reincorporation Merger without registration under the Securities Act of 1933. The Division will not recommend enforcement action to the Commission, if reliance on your opinion of counsel that the exemption from registration under section 1145(a)(1)(B) or 1145(a)(2) is available, the Debtor issues any security inherent in the described purchase rights and the Reorganized Debtor issues its New Common Stock to persons other than DDJ Capital and Mitchell Hutchins in the transactions described without registration under the Securities Act. The Division expresses no view whether such purchase rights are securities within the meaning of section 2(a)(1) of the Securities Act.

New Common Stock issued to persons other than DDJ Capital and Mitchell Hutchins may be resold without registration by any such person who is neither an "underwriter " within the meaning of section 1145(b)(1) nor an affiliate of the Reorganized Debtor. Persons described in section 1145(b)(1) and affiliates of the Reorganized Debtor may effect resales under an effective Securities Act registration statement, rule 144 (not including the holding period condition applicable only to restricted securities), or another exemption from registration.

While disagreeing with your analysis, the Division concurs with your conclusion that the described transactions to be effected in reliance on section 1145(a) of the Bankruptcy Code should not be integrated with offers and sales to DDJ Capital and Mitchell Hutchins. The Division expresses no other views concerning the validity of the exemptive claim under section 4(2) of the Securities Act as to such offers and sales.

These positions are based on the representations made to the Division in your letter. Any different facts or conditions might require different results. The responses concerning registration under the Securities Act express the Division's position on enforcement action only and do not express legal conclusions on the questions presented.

Sincerely,

Michael Hyatte

Special Counsel

Footnotes

1 The Plan of Reorganization and the Disclosure Statement are combined into one document pursuant to a form prepared and required by the Bankruptcy Court.

2 17 C.F.R. §230.145(a)(2) (1997).

3 This request letter has been filed promptly with the Commission upon finalization of the SBCWDR Letter.

4 As of April 30, 1998, the face amount of the claims of such Bondholders was approximately $26,536,500.

5 513,158 (i.e., the number of shares of New Common Stock subject to the New Warrants and Management Grants) divided by 5,263,158 (i.e., the total number of shares of New Common Stock, on a fully diluted basis, to be issued or issuable on the Effective Date) is approximately 10%.

6 Based on the assumption that all such Bondholders elect to participate in the Bondholder Contribution (if no such Bondholders elected to participate, then no such Bondholders would be exchanging anything other than their allowed claims for New Common Stock). Such Bondholders hold approximately 50% of the allowed claims of all Bondholders.

7 *See* footnote 6.

8 Because, as set forth in the SBCWDR Letter, it is estimated that the Reorganized Debtor will have an implied equity value, and because such implied equity value will exist net of the portion thereof attributable to the New Warrants, the Management Grants and the New Common Stock to be issued to DDJ Capital and Mitchell Hutchins (including pursuant to the DDJ Capital/Mitchell Hutchins Contribution Obligation), those circumstances in which the Commission has objected to the applicability of Section 1145 (a)(1)(B) on the basis that a debtor's securities had no underlying value because such debtor had no assets should not be relevant with respect to the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act) or the New Common Stock to be issued by the Reorganized Debtor to the Bondholders other than DDJ Capital and Mitchell Hutchins (including the Bondholder Contribution New Common Stock). *See* , *e.g.* , In re Penn Pacific Corporation, Debtor, Case No. 94-00230, Objection of the Securities and Exchange Commission to Debtor's Application for Determination of Applicability of Bankruptcy Code Section 1145 to Debtor's Second Amended Plan of Reorganization, 882 PLI/Corp 47, 103 (where (1) plan of Chapter 11 debtor provides that secured creditors, unsecured creditors and holders of old common stock will receive new common stock in exchange for their claims and interests and will be required to contribute $.01 for each share of such new common stock, and (2) disclosure statement states that old common stock has traded on an isolated basis at $1/32 per share, but that such debtor has no assets, the Commission took the position that Section 1145(a)(1)(B) was inapplicable to such new common stock because the debtor had failed to make a substantial showing that the value of the claims and interests being exchanged exceeded the value of the new cash to be contributed for such new common stock); *In re* Custom Laboratories, Inc., 1987 SEC Lexis 4127 (Bankr. D. Minn. 1987) (Commission objected to debtor's proposed plan of reorganization and disclosure statement on the basis that it did not establish that the proposed sale of securities to existing shareholders in exchange for such shareholders' stock complied with Section 1145(a)(1)(B) insofar as there was no apparent value to the debtor's existing shares); and *In re* Cordyne Corporation, 1987 SEC Lexis 3072

(Bankr. D. Oreg. 1987) (bankruptcy court, agreeing with the Commission's objection, denied confirmation of debtor's plan of reorganization where debtor was without assets and proposed to issue, to the shareholders of an unrelated entity (which shareholders did not have a prepetition claim against or interest in the debtor) new common stock pursuant to a merger in reliance on Section 1145(a)(1)).

9 In *Jet Florida System, Incorporated* , the estimated implied value (as opposed to face amount) of the claims to be exchanged for common stock ranged between $5.88 million and in the Bondholder Contribution will be required, prior to the $6.96 million, which was greater than the potential $4.392 million of new cash to be exchanged by the creditors holding such claims (the ratio of claims to new cash being 1.34 to 1.58). With respect to the "purchase rights " inherent in the Bondholder Contribution Election Procedure (to the extent such "purchase rights " constitute a separate security under the Securities Act) and the New Common Stock (including the Bondholder Contribution New Common Stock) to be issued to Bondholders other than DDJ Capital and Mitchell Hutchins, as set forth above, the estimated implied value (as opposed to face amount) of the allowed claims to be exchanged for such securities ranges between approximately $13,650,000 and $23,100,000, which is greater than the maximum $7.5 million of new cash that may be contributed by such Bondholders pursuant to the Bondholder Contribution (the ratio of claims to new cash being 1.82 to 3.08).

10 *See* 8 *Collier on Bankruptcy* ¶ 1145.02[1][a][iii] (15th ed. rev. 1998) (favorably citing Mitchell, *Securities Regulation in Bankruptcy Reorganizations* , 54 Am. Bankr. L.J. 101, 118 (1980)).

11 *See* 8 *Collier on Bankruptcy* ¶ 1145.02[1][a][iii] (15th ed. rev. 1998).

12 "The obvious purpose of Section 1145 is to encourage reorganization and to relieve bankrupt entities of the strict requirements of securities laws so long as adequate disclosure is made. " *In re* Amarex, Inc., 53 B.R. 12, 14 (Bankr. W.D. Okla. 1985).

13 17 C.F.R. §230.144 (1997).

14 15 U.S.C. §77d(2). Under such a characterization and view, such New Common Stock issued to DDJ Capital and Mitchell Hutchins would constitute "restricted securities " within the meaning of Rule 144 under the Securities Act, and could not be resold except pursuant to registration under the Securities Act or an applicable exemption therefrom (and the certificates evidencing such New Common Stock would contain a legend reflecting such restrictions).

15 17 C.F.R. § 230.152 (1997).

16 As discussed above, such result applies also to securities issued under Section 1145(a)(2), as recognized by the Division.

17 Such five factors are (1) whether the different offerings are made for the same general purpose, (2) whether such offerings are part of a single plan of financing, (3) whether the offerings involve issuance of the same class of security, (4) whether the offerings are made at or about the same time, and (5) whether the same type of consideration is to be received. *See* Non-public Offering Exemption, Securities Act Release No. 4552, 1962 WL 3573 (Nov. 6, 1962).

18 Except, arguably, with respect to such "purchase rights " (to the extent such "purchase rights " constitute a separate security under the Securities Act).

BOARD AND CEO ADVISORY PARTNERS

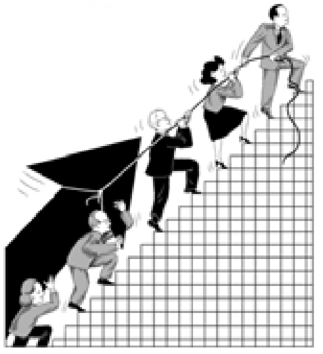
Building Boards for Companies in Bankruptcy

Solving the Twelve-Variable Equation

Clarke Murphy, Tom Long

PRINT SHARE DOWNLOAD PDF

In this issue, the Russell Reynolds Associates CEO/Board Services team discusses common challenges and best practices in putting together a board for a company emerging from bankruptcy. Our CEO/ Board Services Practice has worked with numerous billion-dollar public companies to recruit new boards as part of Chapter 11 or parallel insolvency proceedings in other jurisdictions, including NewPage, Dynegy, SemGroup, Calpine, Quebecor Printing, SuperMedia, YRC, Kaiser Aluminum, Northwest Airlines, NorthWestern Energy, Mirant, NRG Energy, Xcel Energy, Canwest Newspapers and AbitibiBowater Holdings.



Nothing quite compares with conducting a board search for a public company preparing to emerge from bankruptcy.

In an age of activist shareholders, Sarbanes- Oxley and wary director candidates, every public company board search carries its own set of complexities, as well as a sense of working under the scrutiny of multiple constituencies. Nothing, however, quite compares with conducting a board search for a public company preparing to emerge from bankruptcy. All the factors at play in a traditional board search—prioritizing the qualities of desired candidates, balancing the perspectives of various factions, and managing the wooing process between candidate and board—are present to a heightened degree. As a result, bankruptcy board searches are an illuminating case study in the dynamics of corporate governance.

The Complexity of the Task

In a bankruptcy board search, of course, the mandate is to fill not just a single board seat but an entire board more or less from scratch—a condition that significantly complicates the task. In filling a single seat, determining the ideal characteristics of a new director is fairly straightforward, given that the qualities of all the other players are established. One knows the boardroom culture into which a new director must fit. In the post-Chapter 11 case, however, there is no pre-existing boardroom culture, only an empty table.

Solving any equation with 10 or 12 unknown variables is a daunting task. To make the situation even more challenging, there almost always is significant time pressure, given that a board slate must be submitted several weeks before the hearing date set by the judge overseeing the case, and the exercise of naming a board usually gets pushed to the end of the bankruptcy process due to all the critical and contentious issues that also must be resolved, such as negotiating with banks and unions, before the composition of the board even can be considered. Thus, putting together a board does not begin until time is short and nerves are frayed from the heated arguments that have occurred along the way.

From the perspective of the search firm advising the search committee, the charged nature of a restructured company board search usually is apparent from the beginning since the first task is to convince all parties represented on the committee—debtors, management and creditors (sometimes joined by incumbent directors)—that the search firm will be an objective facilitator that cannot favor one side over another. Fortunately, this normally is fairly easy to accomplish, given that the search committee's suspicions generally have more to do with each other than with any third party. It also is part of the search consultant's initial role to educate the search committee on the charge and keep the committee focused on the problem at hand. Unlike a standard search committee, which usually is composed of board directors who often are current or former CEOs and, thus, are well-versed in boardroom matters, a restructured company search committee frequently is largely populated by creditor representatives with limited direct experience in corporate governance issues.

In an assignment to fill a single director seat, the first step is to develop a list of attributes likely to be required in that person—perhaps expertise in marketing or corporate finance, experience in emerging markets or track record as a change agent—as well as to identify the desired management style and governance philosophy to complement or counterbalance the existing board's personalities. When the charge is to fill an entire board, however, one must construct a list to cover the competencies needed by the entire group, as well as the collective governance style best suited to the task of moving the company forward. Getting consensus on the list of attributes—that becomes the filter against which potential candidates are screened— usually is one of the least contentious steps in the process. The difficulty, however, comes later, in assembling the right combination of table pounders and conciliators, up-throughthe- ranks traditionalists and entrepreneurs, industry veterans and those from entirely different fields to result in a cohesive team that can provide a wide range of counsel and oversight to the new management.

Bankruptcy board searches are an illuminating case study in the dynamics of corporate governance.

The Search Begins

Ultimately, all parties agree on a wish list of candidates to approach. The executive search team further augments the list so that there are eight to 10 candidates for each seat to be filled. Doing so involves not only extensive database searching and research but also a great deal of internal discussion and discreet plying of sourcing networks to go past the usual suspects:

- Who are the rising executives on the cusp of being elevated to CEO?
- Which CEOs might be near retirement and thus able to take on a new challenge?
- Who looks great on paper but might not have the temperament to shine in a turnaround scenario or who might be burdened with disqualifying conflicts?

Since some executives reject post- restructuring directorships out of hand, some potential candidates will be sounded out in general terms on the opportunity. (Such skepticism often is misplaced, given that companies emerging from bankruptcy are doing so with a clean slate. It is a pre- bankruptcy board one wants to avoid joining.) The process then returns to the search committee where the candidates are reviewed one by one. In addition to the pool that has been submitted, members of the search committee sometimes will have suggestions of their own. There is nothing wrong with that—as long as these candidates undergo the same process of scrutiny and analysis as everyone else. The premise of emerging from bankruptcy is a clean slate—so no one candidate should have an inside track to an oversight role.

The New Board Takes Shape

As the shaping of the board begins, the perspectives of the various players on the search committee become readily apparent. While debtors, management and creditors all have the same ultimate goal—for the company in question to successfully emerge from bankruptcy—they each are likely to have different priorities in how that is accomplished. For example, the debtors, who likely will be holding stock in the reorganized entity, might favor high-profile directors who will catch the eye of the business press and analysts and who will inspire confidence among shareholders.

The new management, however, might have little interest in that brand of sex appeal, focusing instead on executives with purely functional expertise who can be counted upon to roll up their sleeves and be an active resource. And the creditors—whose ties with the company generally end on or shortly after emergence—usually are looking for all tasks to be wrapped up on schedule with a minimum of disruption. Board composition— like everything else in the bankruptcy process, even down to the location of meetings—is viewed by the participants as a zero-sum negotiation.

The key to success is for members of the search committee to recognize that a range of abilities and approaches on the board will ensure that multiple objectives can be met, and this balanced composition makes for a strong board. Accomplishing this, however, demands a candidate pool that is both deep and wide enough to provide an array of options for each constituency. It also places a premium on identifying and highlighting candidates whose attributes satisfy multiple criteria—for example, a CEO who has overseen the shift from commodity to multiple product lines or a marketing chief who has significant international experience. So it is that 10 names per seat usually are winnowed to six, which is further cut to four once another round of due diligence uncovers disqualifying conflicts that were not readily apparent such as a relative who is an executive at a supplier.

With the candidate pool now at 30 to 40 people, the search committee schedules several separate, full-day interview sessions. Interviewing candidates in a compressed time frame gives the search committee the additional benefit of comparing and contrasting candidates with each other and gaining a vivid sense of the chemistry mix offered by various candidate combinations. Interviews typically last an hour and center on the aspects of the candidate’s career most relevant to the challenges faced by the emerging company; prior board experience; views on management/ board relations, roles and responsibilities; and ability to commit the necessary time and energy.

During the third interview day, incumbent directors who wish to be considered for the new board are interviewed along with the remaining candidates. This sets up the interesting dynamic of directors being interviewed not only by their peers (the other incumbent directors, if any, on the search committee) but by the debtors and creditors with whom they have been in heated and frequently acrimonious negotiations for the past several months. Not surprisingly, there often is an extra layer of cordiality as everyone tries to set aside past conflicts at least for the moment. But no matter how well- behaved everyone is, it is an uphill battle for an incumbent to stay on the reorganized board.

The premise of emerging from bankruptcy is a clean slate—so no one candidate should have an inside track to an oversight role. The first thing candidates usually want to know is who will be in the foxhole with them.

Solving the Equation

After time for reflection, the search committee convenes again to make its selections. At this critical, high-pressure stage, some committees may revert to a zero-sum perspective and treat the proceedings like a major league sports draft, complete with I'll-give-you-yoursif- you-give-me-mine horse trading. Instead, committee members need to look at the big picture. After all, it is not a question of trading one candidate for another but rather solving an equation with 12 variables. And in focusing on how various combinations of people are likely to interact, there will be numerous occasions in which an excellent candidate will have to be cut from the list because he or she would unbalance, in one way or another, the board being built. Those hard decisions will have to be made collectively in the common ground that has been identified between each group's line in the sand of non-negotiables.

Finally, somehow, the dust settles, and a consensus is reached. Offers are extended—and inevitable questions must be addressed. The first thing candidates usually want to know is who else has been asked to serve—who, in other words, will be in the foxhole with them? Prospective directors also will want a sense that the company really is working with a clean slate, with a new management team and a minimum of incumbent directors. Many times, evaluating the suitability of the incumbent CEO and senior management team is first on the new board's agenda. Members will want to know if any major acquisitions or divestitures are expected during the first year, given the significant due diligence work involved in those transactions, as well as upon which committees they might be asked to serve. For instance, offers that include requests to serve on the audit committee frequently bring serious pushback.

There also will be standard inquiries about time commitments and logistics, including the frequency of board meetings outside the country and the possibility of phone participation. This last detail carries real significance: No one wants to be the person who dutifully treks across the country to a board meeting only to find that half the colleagues are phoning in. Given the challenges and time commitment of being a director of a company emerging from bankruptcy, why would someone accept in the first place? Just as some executives are drawn to start-ups or international postings, some simply are attracted to being part of a turnaround—an exciting fresh start for an enterprise. Others might have a particular fascination with the industry in question or see the experience as an important professional development opportunity. (If they are not retired, they likely will have to convince their own company's governance committee that there is a good reason to serve on this board before formally accepting.)

Once the board is in place, the search committee usually convenes in a one- to two-day orientation session in which the incoming directors are briefed by the company's new management and key creditors, and time is scheduled so the directors have the chance to get to know each other and agree on how they will work together (including settling upon a work plan). This provides an opportunity for the board members to begin to outline their mandate prior to the formal assumption of fiduciary responsibility on the day the company emerges from bankruptcy.

The difficulty is in assembling the right combination of table pounders and conciliators, up-through-the- ranks traditionalists and entrepreneurs, industry veterans and those from entirely different fields.

Lessons to Consider

Building a board for a company emerging from bankruptcy is a special case in many ways. At the same time, however, there are several lessons that apply to more conventional director searches:

- Look for candidates who can satisfy multiple skill sets. It is inevitable that several members of the search committee will have strong ideas about the qualities that a new director should possess. It is worth the investment of energy to try and find those candidates who can meet multiple criteria.
- Think through a new director's impact on the culture of the board. Adding a new director is not just compiling a list of competencies. He or she—and the respective unique leadership style—will affect the dynamics of the board. The implications of choosing a particular candidate need to be weighed in the decision-making process.
- Follow a structured process. Given that the search committee likely has a great deal of experience working together, it can be tempting to cut corners in certain aspects of the selection process. But being deliberate about each step—determining criteria and sourcing and evaluating candidates—not only leads to better results but to a clearer understanding of the board's strengths and weaknesses, culture and the particular way in which it exercises its oversight role.

Authors

Tom Long is a Managing Director, based in the firm's Toronto office, with nearly 20 years of experience in recruiting CEOs, senior executives and board members for corporate clients across a range of industries.

Ron Lumbra is a Managing Director and Co-leader of Russell Reynolds Associates' CEO/Board Services Practice in the Americas. He has nearly 15 years of experience advising prominent global organizations on board director recruitment, CEO recruitment and board/CEO succession planning. Ron has significant expertise advising on building boards in post-bankruptcy and other restructuring scenarios.

Clarke Murphy is a Managing Director in Russell Reynolds Associates' New York office. Clarke leads the firm's global CEO/Board Services Practice and has more than 20 years of experience recruiting board directors, CEOs and senior-level executives for leading global corporations.

Russell Reynolds Associates

Leadership, Succession and Search | In today's global business environment, success is driven by the talent, vision and leadership capabilities of senior executives. Russell Reynolds Associates is a leading global executive search and assessment firm with more than 300 consultants based in 41 offices worldwide. Our consultants work closely with public and private organizations to assess and recruit senior executives and board members to drive long-term growth and success. Our in-depth knowledge of major industries and of our clients' specific business challenges, combined with our understanding of who and what make an effective leader, ensures that our clients secure the best leadership teams for the ongoing success of their businesses. www.russellreynolds.com

Featured Insight

BOARD AND CEO ADVISORY PARTNERS

Engaging the Activists

APRIL 2010

Lessons on Creating or Rebuilding a Board

Cornerstone of the Board

By: Julie Hembrock Daum, Thomas J. Neff

Corporate boards tend to be very stable organizations, generally with little director turnover from year to year. However, there are scenarios in which boards are created essentially from scratch or must be aggressively reinvented — when a company is taken public, spun off from a parent or rebuilt after bankruptcy or a crisis.

These situations provide the rare opportunity to shape the composition of the board to reflect the direction, challenges and opportunities of the new or reinvented company. These new boards should be consciously and carefully constructed with the particular focus of creating a board capable of guiding the new entity.

Based on our significant experience helping companies build or rebuild their boards, we have a definite point of view on how to proceed. Looking across a number of these engagements with clients, we have documented what we believe to be the best practices in the following blueprint for building a board.

- Start with strategy

- Secure board leaders
- Create a matrix of desired board skills
- Consider the board culture and organization
- Understand the special considerations for different scenarios

Understand the Special Circumstances

While the fundamentals of building a new board are similar, it is helpful to understand the unique characteristics and issues associated with spinoffs or companies preparing for an IPO or undergoing reorganization, which are highlighted in the next few pages.

SPINOFF

Maintaining an element of continuity with the parent company may be an important consideration. This is a way of ensuring institutional memory and can be achieved by bringing at least one director from the parent company onto the board. Bridging the old and the new can be a useful role for an elder statesman director who is nearing retirement. Tapping an individual who is knowledgeable about the parent, as well as the logic and business of the spinoff, for the new board can help it get off to a good start. At the end of his or her term, the director may cycle off the board, opening a space for a new director. This allows the board to identify a need that directors may not have predicted when forming the board.

Everything flows from the strategy

Building a new board should begin with a thoughtful, detailed process and upfront planning that starts before the actual search for director candidates begins. Regardless of the specific situation — a reorganization, a spinoff or an IPO — the foundation of this process is a thorough understanding of the future strategy of the company.

In all of these situations, understanding the strategy enables the next logical step: determining the set of talents, backgrounds and knowledge needed on the board to evaluate and propel the strategy.

Start with strong board leadership

While board leadership is always an important consideration, it is even more crucial when constructing a new board to ensure it — and the company — get off to a strong start. The first step is to evaluate the board's leadership requirements.

An important early consideration is whether the chairman and CEO roles should be separate or combined with a single individual. It is common for the chair and CEO roles to be split in new boards because of the diverse responsibilities associated with establishing the new entity — from operating responsibilities, to working with a vast array of internal and external constituencies, to getting the board off to a strong start when there is no corporate or governance structure or legacy on which to rely.

Bankruptcy or Crisis

In bankrupt, distressed or financially vulnerable companies, recruiting new directors may be necessary to regain credibility with key investors, customers and, sometimes, with regulators. In these situations, the board may be overseeing a restructuring of the company and may need to evaluate and potentially replace the CEO. For these reasons, it can be important to have a strong nonexecutive chairman to lead the board as it assesses the strength and suitability of management for the restructured business and ensures that restructuring milestones are met. A nonexecutive chairman also serves as an independent voice to stakeholders. Given the complex strategic, operational, financial and legal aspects of restructuring, there is a need for directors with significant financial acumen and industry-specific knowledge and those who have the desire and time to dedicate to the board's work.

In the case of a spinoff, the CEO often is a senior executive from the parent company who has been chosen to lead the new company. He or she may have no prior experience as the CEO of a public company, with all of its attendant governance requirements and other new demands beyond those on a divisional leader. Similarly, in an IPO, a CEO is typically in place already, but may not have public company experience. In a reorganization, boards frequently have a nonexecutive chairman who can serve as an independent and credible voice to shareholders and other stakeholders as the company emerges from the crisis. In a restructuring, the first job of the board often is to determine if the company has the right CEO. The chairman should have the time and skills to lead a CEO search succession process and possibly serve as an interim CEO. If the chairman and CEO roles will eventually be combined, the board must have a lead independent director.

The nonexecutive chairman or lead director. Begin by determining all the characteristics the company will need in the board and the CEO in order of priority. Evaluate which of those traits the CEO brings and identify the complementary traits that would be valuable in the nonexecutive chair or lead director.

Look for an anchor or magnet figure to serve in the role of lead director or nonexecutive chair, as this person can be a powerful force in attracting other valuable directors. Indeed, this individual may be charged partially with selling the opportunity. Recruiting a strong, independent leader for the board who has both the experience and the credibility — whether dealing with employee groups or investors — will be a huge asset in building an effective board. For these reasons, and because of the significant time commitment, nonexecutive chairs or lead directors of new boards are often retired CEOs or chairmen of other public companies.

Initial Public Offering

A company preparing for a public offering typically recruits directors with significant public company experience, especially former CFOs or others with public company finance expertise. In situations in which the CEO does not have public company experience, many boards have established the role of nonexecutive chair, who can provide an experienced voice to the CEO and, by managing the board, allow the new CEO to focus on running the company.

A nonexecutive chair or lead director's duties include:

- Preparing the agenda for and chairing board meetings
- Organizing the board to do its work, for example, helping to determine who chairs which committees
- Leading the governance process
- Leading the CEO and board evaluation processes
- Spearheading CEO succession planning
- Leading the board in executive sessions

When the chair and CEO roles are combined, then the lead independent director will provide important support to the CEO/chair and the rest of the board in carrying out these duties.

Key committee chairmen. Another leadership position that is a priority to fill is the audit committee chair. As the responsibilities of audit committees have expanded, the importance of recruiting a capable audit committee chair cannot be overstated. Given the weighty and complex duties demanded of this position, new boards especially require an individual with financial expertise and public company board experience, as well as the time to devote to this role. Once this position is anchored, it will be easier to recruit others to serve on the audit committee. Individuals subsequently recruited for the audit committee will have more confidence that the audit committee will be run well, and will be less concerned that serving on the board will expose them to significant risk.

For many boards, recruiting a skilled compensation committee chairman also has become a priority because of the intense scrutiny on executive compensation.

BOARD-BUILDING CHECKLIST: RECRUIT STRONG BOARD LEADERS

- ☐ Secure the best board leadership, as early as possible.
- ☐ Consider best practices regarding the CEO and chair roles, and determine which model — one that combines the CEO and chair responsibilities or one that separates the roles — is most relevant to your new board.
- ☐ Determine the qualities and experience most critical in a lead director or nonexecutive chair for your new board.
- ☐ Make it a priority to recruit strong committee chars, starting with audit and compensation committees.

Developing a skills matrix

An effective strategy to employ in assembling the rest of the board is to think in terms of a skills matrix. Each square of the matrix reflects a "must have" or "nice to have" skill or experience, such as prior board experience, industry expertise, specific board committee experience (audit or compensation, for example) or specialized expertise in areas such as international business, marketing, technology or finance. Once developed, the idea is to fill in the matrix with priority requirements when recruiting directors.

Matrices and priorities will, of course, vary depending on the nature of the business, its strategy and current situation. For example, in a post-bankruptcy reorganization, it may be valuable for the board to have someone who has been through a restructuring or a former banker who can consider possible transactions. In an IPO situation, a former CFO with significant public company experience or a former investment banker with extensive experience in financing may be in demand.

One important category in the matrix is diversity. Rather than being considered an end in itself, diversity is increasingly considered an underlying dimension or criterion when potential directors are sought for skills or experience. More and more, boards recognize that including diverse perspectives on the board — in the areas of age, gender, race and ethnicity and, in some cases, geographic knowledge — is important. Boards are not normally embracing diversity to be politically correct or because of outside pressure, but because it expands their views on issues, options and solutions. It's diversity of thought that is important and an advantage in board discussions and deliberations. That comes from having directors who don't all come from the same mold, but from different backgrounds and experiences. Age is important because the board wants to have appropriate turnover and not lose all board members in the same year when they hit a mandatory retirement age.

The matrix also should include consideration of the board's committee requirements. In addition to the audit committee, the board needs knowledgeable independent directors to lead and serve as members of the compensation and nomination and governance committees. For a compensation committee chair, the desired background might include a public company CEO with a great deal of board experience, or someone who has previously served as a compensation committee chair, and others with expertise in human resources or compensation. Whoever is selected, the individual must be up-to-date on compensation issues and trends, as well as a decision maker who can lead the board in creating an appropriate and explainable compensation model. The nominating committee chair should be experienced in board governance and have a thorough understanding of best practices and evolving trends in corporate governance.

BOARD-BUILDING CHECKLIST: DEVELOP A SKILLS MATRIX

- ☐ Think holistically about director recruitment as opposed to one-off recruitments.
- ☐ Develop a matrix of the overall skills and experience required for the board. Use the skills matrix to ensure the bases are covered when recruiting.
- ☐ Think about the various diversity dimensions that would be valuable to include on the new board, including geographic representation.
- ☐ Outline specific requirements for key committee chairs.
- ☐ Consider specific constituencies that will be important to the board and recruit directors who are familiar with them.

Lay the groundwork for a cohesive board team

One of the characteristics of an effective board is that directors bring varied perspectives to boardroom discussions, yet work well together. They know why they have been recruited and what is expected of them, both as individuals and as a team.

Recruiting for cultural fit. Teamwork is critical to the effective working of a board. Those leading the search will be able to get a good feel for a candidate's fit in the course of conversations with a prospective director. The first thing to test with director candidates is how they think about governance. Candidates should have a healthy and contemporary view on governance, neither diminishing its importance nor allowing compliance to overshadow the board's broader role in strategy and succession planning. Look for directors who are able to question, discuss, listen, express an opinion and articulate differences in a constructive way. The best directors are willing to make the tough decisions and be accountable, while being a team player.

Getting off to the right start. Building a cohesive board culture is vitally important. These efforts are particularly important when a board is starting from scratch and has no culture, tradition or even relationships on which to build. Many new boards start the culture-building process by having directors regularly meet over dinner before each board meeting. An informal dinner or similar social gathering allows directors to bond before they begin to work as a group.

In addition, some boards have found it invaluable to have an orientation on important business issues or governance-related topics before the first formal board meeting, when they must deal with actual board issues. Convening directors informally for training helps the board to get off to a fast start once their formal responsibilities begin.

Of course, not every board has the luxury of time to gradually acclimate directors — particularly in a reorganization. But, if possible, the cohesion that develops among directors will pay dividends down the road when the board has to work as a team on difficult issues and under time pressures.

BOARD-BUILDING CHECKLIST: PAY ATTENTION TO CULTURAL FIT

- ☐ Define the desired board culture and personal director traits to ensure congruency.
- ☐ Plan kick-off events for new directors, including social dinners and a board orientation, that will model and reinforce the culture.
- ☐ Plan ongoing training and information sessions with the board to ensure all directors receive the company knowledge they need to effectively carry out their duties as board members.

Organizing the board to accomplish its work

An important task early on is to determine the governance structure and parameters for the new board and the potential impact on director recruitment: board size, committees, frequency and location of board and committee meetings, and director compensation. In some cases, these may be built upon the existing policies of the parent company or the current board, as in the case of a reorganization or spinoff.

Adopting progressive governance and compensation programs may be viewed as a signal of things to come, and thus a way of attracting first-class directors. It can be helpful to develop a recruiting manual to describe the basics of the company, including the key businesses and personnel, corporate structure and locations, relevant company history and the governance policies that will apply.

Board size. We recommend starting small — both in terms of the number of directors and the number of committees — when creating a new board. Ideally, the board should be small enough to have high-quality, active discussions and large enough to be able to populate the committees. It is easier to build up the board than to whittle down once people and structures are already in place. Over time, gaps in the board's skills and committee needs will become evident, and needed modifications can be addressed. So, what is the magic number? From our experience and the experience of those who have led new boards, a good place to start is with a core group of seven to nine directors and with the three core committees — audit, compensation and nominating.

Compensation. Since a newly formed board must compete for and retain the best directors, it generally approaches director compensation in a systematic way. That may mean working with an outside compensation consultant to establish benchmarks by company size and industry to ensure director compensation falls within accepted norms. In the case of restructurings, it may require providing a piece of the upside if the company succeeds.

Directors may spend several months in limbo between the time they are recruited and when they become official members of a functioning board. How do company leaders determine a fair way to handle this limbo period from a compensation perspective, and, further, how do they determine overall compensation for the new board? While compensation is not primarily what attracts top-notch directors to boards, how compensation is handled does speak volumes about how a company values its directors as well as the time and effort they must expend.

To cover the interim period — between signing on and the first board meeting — some boards provide a monthly stipend plus board meeting fees. Others provide a lump sum retainer for directors of the new board, of a sufficient size to solidify their agreement to join the board as well as to fairly compensate them for an estimated three to six days of their time for the six-month interim period.

BOARD-BUILDING CHECKLIST: ORGANIZATION AND PROCESS

- ☐ Determine governance parameters for the new board and the potential impact on director recruitment: board size, committees, the frequency and location of board and committee meetings, and director compensation.
- ☐ Consider building upon the policies of the parent company or current board.
- ☐ Assemble the principles to use in director recruitment.

Questions and Guidelines for Building or Rebuilding a Board

While there is not one right formula to follow when building or rebuilding a board, there are practices that correlate with getting off to a good start as well as with longterm success. Consider the following questions and guidelines to help ensure your board addresses and resolves key issues early on:

Board Leadership

- Will the new board combine or separate the CEO and chair roles?
- If combined, what responsibilities should the lead director have?
- What skills and expertise should the chair or lead director bring? To what extent should these complement the CEO?

Governance Considerations

What governance parameters will the new board adopt? For example:

- Board size: How many directors will serve initially, based on the number of committees planned and the other board responsibilities?
- Committees: Which committees will be established from the outset? What is the process for considering the creation of additional committees?

- Meetings: How frequently will the board and its committees be meeting? When and where will board and committee meetings be held?

- Compensation: How will directors be compensated — retainer, equity, meeting fees, etc. — both in the short term and longer term?

- What are the implications for director recruitment (e.g., number of directors, skill mix, etc.)?

Continuity

- How many directors from the parent or original company's board will be deployed to the new board initially and why?

- How will this process be managed to best ensure continuity?

- What implications will this have for director selection and committee assignments?

Director Expertise and Background

Skills and experiences

- What skills and experiences will be needed on the board to help the company succeed and deliver value to shareholders?

- What should the director skills matrix include?

- What experience is needed by the nonexecutive chair or lead director based on the company's situation and the skill-sets of the CEO?

Committee expertise

- What steps will the board take to ensure committee chairs have relevant domain expertise?

- What skills are critical for the audit chair?

- What skills are critical for the compensation committee chair?

Boardroom culture

- What personal traits are important in directors and how will these contribute to the overall culture of the board?
- What steps will the board take to develop an effective and collegial culture?
- How will new board members be assessed to determine "fit" with the desired culture?

Board orientation

- What steps will be taken to ensure all directors receive the materials and training they need to effectively carry out their duties as board members?

Share:

DOWNLOAD FULL PDF

Vol. 1, No. 17

BANKRUPTCY PROFESSIONAL

September 10, 2009

A Publication of New Generation Research, Inc. • Companion Resource to BankruptcyProfessional.com

IN THIS ISSUE

New Generation Research, Inc.

225 Friend St., Ste. 801
Boston, MA 02114
(617) 573-9550

SPOTLIGHT:

Steven Arnold Seiden, *President*

Seiden Krieger Associates, Inc.

Celebrating its Silver Anniversary, Big Apple-based Seiden Krieger Associates, Inc. was founded in 1984. The firm, which recruits corporate directors, CEO's and CFO's in the full range of industries, explains: "We reach the unreachable. We approach the elite top performers who are already employed in the kind of position you need to fill…or create. And we do it without compromising either you or the executive."

Seiden Krieger Associates' specialty is working with companies in transition, particularly those with new equity or debt holders and it has "satisfied the needs of demanding leaders who seek to build their enterprises and to enhance shareholder value." Clients include distressed debt firms, private equity, acquisitive companies, hedge funds and activists.

Before founding Seiden Krieger Associates, Steven Seiden spent 17 years on Wall Street helping to build and manage a successful financial services and investment banking organization. In addition to his work recruiting senior officers for holding companies, he also finds new management and directors for those companies emerging from Chapter 11 protection. According to the firm, "Steven Seiden…sees your quest for top executives as part of your company's ongoing strategic plan—not simply as a puzzle needing just a peg to fit into a single hole."

A graduate of Yale University and a Veteran of the U.S. Army, Seiden's articles have appeared in *Business Week, The Congressional Record, The Wall Street Journal, Barron's, The Corporate Board, Business Law Today, Director's Monthly* and *Directors & Boards.* We spoke with Steven about the value of executive search in today's bankruptcy arena, the recruitment process itself and how his Army service prepared him for the business battlefield.

BP: How can a search firm be of service in the bankruptcy process?

SAS: Attorneys, investment bankers, restructuring firms and other professionals advising stressed, distressed and bankrupt companies invariably need to recruit first rate new directors and/or officers for their clients. Engaging a search firm like Seiden Krieger Associates to find such professionals usually yields a far better result than is possible using the do-it-yourself method.

BP: Do certain would-be clients try to find their own directors and officers?

SAS: Yes, but I think that's a mistake. For the good of the stakeholders, it's always best to tap the extensive resources that an experienced search consultant can bring to the table. Ultimately that translates into a better, more diverse and competitive board and management team than could be obtained on a do-it-yourself basis. Frequently advisors and investors recycle the same old cronies. While that may be perceived as a safe bet, it hardly optimizes the company's performance going forward.

BP: Why, exactly, does the use of your firm yield better results?

SAS: All too frequently they flip through their Rolodexes and enlist the usual suspects, friends and acquaintances. There is a natural temptation to put cronies on boards of Chapter 11 emerging companies in order to preserve a client relationship. In many instances they are chosen solely to do the bidding of the creditors, debtors or bond holders as the case may be. Their focus is typically short-term oriented.

BP: What's wrong with a shorter-term orientation for those companies fresh out of bankruptcy court protection?

(Cont'd. on p. 2)

SPOTLIGHT

(Cont'd. from p. 1)

SAS: It sells the future stakeholders short. The long-term worth of the company vests with a strategic thinking world class CEO and Board.

BP: How does a company emerging from Chapter 11 protection construct its new board?

SAS: Of course the new equity holders vote for the new board. From a governance perspective, the selection process needs to address the heads and memberships of key board committees. The Nominating Committee ought to be chaired and populated with discerning types who will attract desirable future directors and be capable of winnowing out those whose terms ought not be renewed.

BP: You mention the Nominating Committee. What other Committees are critical to the Board?

SAS: The Compensation Committee is key to good governance, particularly given the national attention focused on executive pay. Its members need to be totally objective and independent and align the CEO's and top officers' packages with enhancing shareholder value. It's not a bad idea to include on that Committee a sitting senior Human Resources Officer from a comparable company with considerable experience in executive compensation. In fact, I sense the beginning of a trend in that direction in the same way that the members of the Finance Committee of the board need to have a suitable financial background so as to comply with Sarbanes-Oxley.

BP: Given the financial meltdown we've just seen, how do you find responsible types to be on the new Finance Committee?

SAS: I look for people such as CFO's, Controllers and Treasurers who truly understand the sophisticated nuances of financial statement analysis and particularly risk assessment. Someone who's merely worked for a financial company but who lacks the true insight to ask penetrating questions simply won't do.

"The long-term worth of the company vests with a strategic thinking world class CEO and Board."

BP: The issue of risk seems key in these times. How does the board of a post-bankruptcy company deal with the ever-present risk factor?

SAS: By putting enlightened professionals on the Finance Committee who have demonstrated a keen ability to ferret out how prudently the top officers of the company have mapped out a strategic plan which clearly addresses the internal and external threats to the company's future as well as its weaknesses. Some companies have now wisely created separate Risk Committees as a component of the board.

BP: Aside from technical skills, what does the board of a company emerging from Chapter 11 protection really need?

SAS: To begin with, it's not much different from a company going public for the first time. First and foremost, the new directors, aside from the CEO, should be unquestionably independent and unfettered by any conflicts including any loyalties, however subtle, to management. Boardroom savvy is also important. That's the ability to understand and be a valuable contributor in a group dynamic setting. It's about being constructively critical when demanded but never destructively critical. There are potential directors who have never been on a board but who instinctively have the requisite skills and know how to comport themselves. In short, the new board should become a competitive advantage to the company.

BP: How do you evaluate future board members?

SAS: I do it differently than most and in a way that's proven quite successful. You're never going to be able to take the measure of a man or woman solely through an interview. After all, what can I learn about how good a person will be on a board in a two-hour meeting? The way to find out, in my judgment, is to meet in person with other board members, preferably the lead director or committee head on which he/she has served. Those are the most reliable references. And doing it on the phone is far less worthwhile. You need to look that fellow director in the eye and really probe as to what kind of director he/she has been.

BP: Does that apply to the recruitment of a new CEO or CFO?

SAS: Absolutely. I'm more interested in what's not on a resume that what is. The search consultant needs to conduct those references face to face. I've frequently traveled to another city to spend a few minutes with a reference who really knows the CEO or CFO well and who will candidly discuss his or her strengths and weaknesses.

(Cont'd. on p. 7)

SPOTLIGHT

(Cont'd. from p. 2)

BP: Do you specialize in any industry?

SAS: No. I think it's relatively easy to identify viable candidates given the extensive amount of corporate data available on the web. The trick is to persuade a reluctant star—and most are—that the position for which you're recruiting is better than his or her present one. Indeed, the successful search often begins when the candidate says, "No."

BP: Who recruits you to conduct a board, CEO or CFO search?

SAS: It can be the lawyer for the creditors or the debtor. Frequently it's the turnaround professional or the investment banker. So called "loan to own" investors usually need to engage an executive search firm when they control the company. It's not uncommon to meet well in advance so Seiden Krieger Associates will be viewed as a future resource.

"There's a mid-ground on any team between going along to get along and being too aggressive about pushing your own agenda."

BP: What differentiates Seiden Krieger Associates from other search firms?

SAS: Our passion for quality in every phase of the search process. I like to say that a quality search is the sum of judgment, resourcefulness and speed.

BP: What drew you into recruiting directors for bankrupt companies?

SAS: I got a call a few years ago from a director of a company, Finevest Foods. They were about to file under Chapter 11 and asked me to put together a new board, including recruiting a new CEO. The directors needed to be from specific backgrounds. Finevest was a multi-line purveyor of dairy products sold in supermarkets. I recruited Steven D'Agostino, formerly of that family-controlled food chain; Dennis Toura, a well known turnaround and restructuring consultant; and Raymond Troubh, a professional director with a wealth of governance experience. These three outstanding directors each brought essential skills to the boardroom table and were able to hit the ground running. That greatly contributed to the company's future success. This initial assignment opened my eyes to how important it is to have an independent blue ribbon board as a company emerges from bankruptcy, just as it is for the board of a newly going-public company.

BP: With the present economy and number of senior-level layoffs, do you find yourself being pursued by would be "recruitees"?

SAS: I find that this economic climate has brought about an interesting phenomenon: polarized executives. On the one pole, the good executives tend to stick closely to the companies for which they've already performed and brought financial results. There is a great deal of loyalty, and it's harder to extract those candidates: "The devil they know might be better than the devil they don't know." In a better economy, that individual is not as worried about pursuing a new opportunity because they can easily find something else if it doesn't work out.

On the other pole, companies are releasing mediocre players. You have to be very careful with all of those resumes flooding your computer. Those are the ones about whom you need to be even more suspicious. Search firms need to be skeptical of potential candidates at all times, but that is especially true in this economy.

BP: Your resume indicates that you served in the U.S. Army. What can you tell us about your time in the military and how has that training helped with your current endeavors?

SAS: I think in the Army one of the things that I learned early on is the art of teamwork—something on which a corporate board needs to focus. There's a mid-ground on any team between going along to get along and being too aggressive about pushing your own agenda. Both in a platoon and in a boardroom, the group needs to provide a competitive advantage to winning.

Seiden Krieger Associates, Inc.

Steven Arnold Seiden
(212) 688-8383 | steven@seidenkrieger.com

VOL. 27 | NO. 2
PUBLISHED BY TURNAROUND MANAGEMENT ASSOCIATION

JOURNAL OF CORPORATE RENEWAL

JCR

TURNAROUND.ORG

MARCH 2014

Assembling an Ideal Board for a Post-Bankruptcy Company

BY JOHN S. DUBEL, CEO, DUBEL & ASSOCIATES LLC &
STEVEN A. SEIDEN, PRESIDENT, SEIDEN KRIEGER ASSOCIATES

FEATURE

Until recently, pre- and post-bankruptcy boards of directors were typically populated by a stalwart cadre of individuals representing creditors who were becoming equity holders and whose main focus was on short-term objectives rather than long-term strategy. However, a trend is developing to appoint situation-specific independent directors to serve the best interests of a company as a whole, not merely the creditors individually.

Such a board ultimately plays a critical role in maximizing stakeholder value, which in the end benefits creditors who have converted to shareholders. The issues attendant to assembling and recruiting these blue ribbon boards is explored in this article.

Initially, the differences between recruiting directors for financially healthy companies versus those emerging from bankruptcy must be understood. Usually the former involves seeking one or two directors when vacancies arise, particularly if the board is elected on a staggered basis.

Boards for post-bankruptcy companies, however, are recruited in their entirety and must be approved by the court in toto. Prior to this submission, various creditors have the final say in choosing all or some of the individuals included on the board slate. In a non-Chapter 11 company, the board's nominating committee, acting as a proxy for all stakeholders, puts directors on a ballot for election at the annual meeting.

In contrast, the bankruptcy process usually involves more-complex negotiations among creditors and the debtor to put together a slate of directors. Moreover, desirable director candidates are often understandably reluctant to serve on a post-bankruptcy board. Their fears abound. Will the company stay healthy, or will it revert to its old ways and be forced into a second Chapter 11? Is the new balance sheet sufficiently delevered? Have the necessary strategic reforms been instituted? Is the right management team in place? These are questions which, though carefully considered by any potential director, create particular apprehension in a post-Chapter 11 context.

At least three months before a slate is submitted to the court, a subcommittee of creditors should be chosen to consider retaining an executive search firm or other impartial advisor with bankruptcy experience.

Deliberative Process

So what is the best strategy to pursue in search of the ideal board for a company emerging from bankruptcy?

Above all, ample time must be allocated to the process, both in terms of hours and of scheduling. At least three months before a slate is submitted to the court, a subcommittee of creditors should be chosen to consider retaining an executive search firm or other impartial advisor with bankruptcy experience. A written position description should be developed that addresses three critical categories of director qualifications:

1. An individual's professional and industrial experience as it relates to the needs of the company going forward

2. A potential director's viability as a member or chair of one or more of the following board committees: audit, compensation, nominating/governance, and risk; one individual must qualify as chair or lead director

3. Diversity among board members and demonstrated ability as effective and collaborative members of a board

With regard to the first category, a post-bankruptcy company immediately faces issues critical to its future. As an example, it was determined that when Reader's Digest emerged from bankruptcy, board members needed expertise in areas pertinent to the specific challenges the company faced. Reader's Digest sought to transform itself from a traditional print media entity to a digitally focused one. Thus, someone steeped in e-commerce and new media was sought for board membership.

In addition, the company's cost controls were in need of tightening, so a director with a financial background and previous expense oversight was required. Given the company's growing presence worldwide, those involved in assembling the board slate agreed that a professional with substantial international credentials should be recruited. The company had also recently outsourced much of its information technology functions to India, so it was deemed wise to find a director who had substantial experience with offshore I.T. operations.

During the recruitment of the post-rehabilitation board for FGIC (Financial Guaranty Insurance Corporation), different requirements from those of Readers' Digest were paramount. FGIC's case is the largest to date to be brought before the New York State Insurance Department (since combined with the New York State Banking Department to form the New York State Department of Financial Services.)

FGIC is a monoline bond insurer that, upon emergence, would not be writing additional new policies. Instead, its sole activity would be "running off" its existing policies and paying creditors in accordance with the approved plan of rehabilitation. The process for appointing new board members differed from most cases in that management worked with the rehabilitator and an executive search firm to develop a slate of candidates for the board.

Of necessity, the new board included individuals with some or all the following competencies:

- Knowledgeable in dealing with highly complex transactions
- Some experience in monoline insurance
- A CPA, preferably a partner of a major accounting firm

- Legal experience in the insurance sector
- Credit trained; ideally, a top banking executive
- Familiarity with workout situations

As was true of the post-Chapter 11 Reader's Digest slate—and for that matter, of all boards—none of the directors could be conflicted due to creditor ties, competitive issues, or connections to major suppliers or customers. Total independence is imperative. For both FGIC and Reader's Digest, at least one of the directors needed to possess the leadership skills qualifying him/her to become non-executive chairman.

As mentioned earlier, it's essential that directors be qualified to serve on or chair designated board committees. At the same time, however, none of the candidates should be "overboarded," meaning that they serve on too many other boards of directors.

The audit committee is particularly key in a post-bankruptcy company. Under Sarbanes-Oxley legislation, at least one of its members must be a "financial expert" as the law defines it. In the FGIC board selection process, it was deemed advantageous to have nearly all the candidates qualified as financial experts. Other complex financial services companies emerging from Chapter 11 may be wise to do the same.

In short, each post-bankruptcy situation carries a set of special considerations that should factor into the selection of board members and should be diligently addressed by the creditors. A skilled search consultant or other impartial professional can work collaboratively with creditors, bringing original candidates into the mix and evaluating them together with those suggested by individual creditors to appoint a board best equipped to enhance the long-term value of a company.

To construct an effective board, it is essential to exclude those who merely go along to get along. Homogeneity is not the goal in selecting board members. Enlightened and constructive dissent fosters good governance. Thus directors, in setting a general strategy going forward, should arrive at consensus after healthy debate. Board members must have the capacity to buttress their positions with rigorous analysis of the issues before them.

John S. Dubel (top photo) is CEO of Dubel & Associates LLC and has overseen and advised on a diverse array of restructurings and crises through his 30-plus-year restructuring career, including recently serving as chairman and CEO of FGIC. He also served as CEO of Cable & Wireless America, CFO at WorldCom Inc., and president and COO at RCN Corporation, among others. Dubel holds a bachelor's degree in business administration from the College of William and Mary. **Steven A. Seiden** is president and founder of Seiden Krieger Associates and specializes in recruiting top executives and directors for corporations in transition, including those emerging from bankruptcy and rehabilitation. A graduate of Yale University, he spent 17 years on Wall Street with a financial services and investment banking organization before founding his firm.

Those kinds of thought leaders are the most valuable directors and will likely need to be pursued using adroit recruitment techniques.

Once the position description incorporating the three items referenced earlier has been agreed upon, as well as directors' compensation, these are the recommended next steps in the process:

- A preliminary list of appropriate candidates, along with their biographies/resumés, should be presented to a committee appointed to oversee the selection process; the list should include at least three times as many candidates as board seats available.
- In-person candidate interviews should be conducted by one or more members of the committee.
- The candidate pool should be winnowed down to a reasonable number of desirable individuals; reluctant candidates who are deemed to be particularly valuable should be intelligently pursued.
- Once a list of finalists has been agreed upon, the candidates' references should be checked, both for background flaws (legal, credit, criminal, etc.) and particularly for their track records as directors.
- Assuming that the finalists have served on other boards, their fellow directors on those bodies should be interviewed in person to learn how effective candidates were in a boardroom. An indispensable technique, such in-person discussions are far more revealing than telephone conversations would be.
- Having determined the final slate, election to the board should be proposed in conformance with the court's prescribed submission procedure.

Thoughtful Selection

The process for board member selection described in this article is far different from that employed in many bankruptcies, where director selection is frequently a last-minute agenda item. All too often, with only a few weeks remaining before a plan is submitted to the court, a list of directors containing the names of "retreads"—people who make a profession of representing creditors on post-Chapter 11 slates—is hastily assembled, with little regard for the specific and unique needs of the company.

The best route to optimal board selection and recruitment is hardly a one-size-fits-all approach. Indeed, as much attention and effort as is focused on selecting an executive team must be devoted to the formation of an effective post-bankruptcy board of directors.

DAILYDAC
Distressed Asset Central

Recruiting Post-Bankruptcy Board Directors in the Pandemic Aftermath

March 26, 2021 / By Steven Seiden - President, Seiden Krieger Recruiters

How to Develop Board Committees Equipped for a New Landscape

As Covid induced bankruptcies proliferate, creditors who become stockholders will need to focus not only on the future financial health of the reorganized company, but also on its overall governance. The new post-pandemic landscape will be revolutionary, not evolutionary. It will demand new owners and advisors to construct a multi-talented board, capable not only of reacting quickly and intelligently to dislocations and threats, but more importantly, to crafting a strategy that positions the new company as a leader in its industry.

In this Darwinian environment, laggards will quickly succumb to intensified competition, let alone hostile acquirers and activists.

At the outset, a company emerging from bankruptcy will need to redefine its mission with the enlightened boardroom and management talent to do so successfully. The confluence of new equity holders in a post-Covid world affords precisely that opportunity!

Building a Board of Directors (and Company) Observant of ESG Standards

Even before the crisis, the pressure was building to populate boards with directors whose backgrounds satisfy ESG (Environmental, Social, Governance) standards rather than focused solely on profitability.

What do ESG standards entail?

- **Environmental**—How a company and its board of directors are scored on policies and practices affecting climate change, sustainability, water and energy usage, pollution, conservation, and nature in general.
- **Social**—How a company, guided by its board, communicates with stakeholders (i.e., shareowners, employees, suppliers, and regulators) and manages all internal and external relationships. Both boardroom and company should embrace diversity and inclusivity of all ethnic and gender identities. Policies relating to human rights, animal welfare, and other consumer safeguards are also regarded.
- **Governance**—How the board conducts its responsibilities according to democratic principles. Constituents are expected to be treated with fairness and impartiality. Compensation and power balance along the management structure are also explored.

In short, every company and organization needs to be politically correct in terms of ESG…now so more than ever!

Important Board Committees and Their Roles

That aside, the pandemic will be the catalyst for tectonic upheavals affecting every strata of the business landscape. Not only will companies emerging from Chapter 11 need to focus on their own financial survival, but also how to compete successfully.

Members of the major board committees—Audit, Compensation, and Nominating/Governance—will require uncommon skills and relevant experience as described in the following:

Audit Committee

Besides meeting the Audit Chair's special Sarbanes-Oxley requirements (as differentiated from those of the committee at large) he/she will need to have had multiple experiences in a variety of financial roles in order to cope with complexities of a post Covid world. This includes navigating the cross currents of asset allocation in the wake of capital disruptions brought about by Government intervention and its ripple effects on various segments of the private and public sectors.

Audit committee members going forward should have had considerable experience dealing with the vagaries of financial unrest. Examples include investment bankers and/or corporate treasurers—particularly those who've weathered liquidity storms and are astute risk managers. Experienced restructuring/workout/turnaround types should also be considered. An Audit Chair who has experience with complex balance sheets is key to judging the soundness of a company's financial underpinnings. The pandemic has taught that unpredictable major shocks can dislocate an entire economy. An audit committee must therefore assume a broader role in astutely guiding the board as a whole in turbulent times.

Indeed the audit committee needs to attract farsighted professionals with the awareness to recommend remedial action when something goes off the drawing board of historical experience. Such individuals ideally should possess track records emerging successfully from a threatening circumstance.

Compensation Committee

In this environment, the board should consider charging this committee with the mandate of an over-arching Human Resource Committee. That said, compensation at all levels must be aligned not only with long term bottom line objectives, but also retaining, incenting, and attracting the requisite cadre in what will be an ensuing race for world class talent.

Board committee members ought to be well schooled not only in the basics of HR management, of which compensation and benefits are only a subset, but in talent evaluation across multiple functionalities. Other desirable HR committee skills include career pathing, organizational development and transformation, and navigating workspace in a virtual environment. This includes the technological aspects of maximizing total manpower. Confronting the HR committee will be such concepts as job crafting and re-skilling, in which top executives will be encouraged to redesign their own jobs as the workplace is transformed at ever accelerating speed.

The psychological toll of the pandemic will be a chronic issue which must be proactively addressed. HR committees should be populated by professionals equipped to advise the board on dealing with it.

Nominating and Governance Committee

A refreshed post-bankruptcy board in the wake of the pandemic must, of course, include the aforementioned ESG qualified members. Beyond populating the three major board committees, companies must establish essential and universal qualifications for all board members. It is incumbent on the Nominating and Governance Committee to keep the board relevant on an ongoing basis. It is important to point out that the responsibility of choosing directors immediately subsequent to emergence lies solely with the new equity holders.

Director Qualifications

So what are those universal board qualifications? In this new environment, maintaining and improving quality will be a defining issue for manufacturing and service businesses alike. All directors will be called upon to reinforce the quality imperative. One in-demand board member held the title of Chief Quality Officer in addition to being CEO.

Inherent in quality control and improvement is supply chain management. One Covid lesson is that accessibility to alternate supply sources is indispensable, particularly to JIT (just in time) manufacturing. Directors from that discipline will be coveted, especially as US foreign policy, including trade, becomes more insular.

Related to the above is international and political experience. Board members having such backgrounds will be increasingly valuable as the pandemic creates worldwide dislocations in capital, commodities and intellectual property.

As customers/clients become more selective in the new age of technology-driven disruptive business models, directors (preferably innovators themselves) will need to lead the board dialog on business model transformation.

The pandemic has already created an explosion in e-commerce, software as a service (Saas), and artificial intelligence (AI). With that will arrive the next generation of quantum computers. They will have the capacity to solve multi-variable problems of great magnitude at unprecedented speed. Cybersecurity will be an even greater imperative than presently. Directors who aren't technologically literate won't be able to participate in the boardroom dialog necessary to make informed judgments.

In this challenging environment, the bar will need to be set high regarding the skill set and experiential breadth of all directors and board committees.

Continuous re-validation of company business plans and its very mission will require consummate thought leadership by directors with exceptional track records.

Where to Recruit Board Directors

Where and how to find them? The old "rent-a-director" method won't necessarily surface the kind of enlightened board member described in the foregoing. Those who show up on dozens of post-bankruptcy slates usually don't possess the aforementioned requisite specializations.

Board recruitment in this pandemic will require judgment, resourcefulness, and speed. The new owners need to form a highly productive and industrious search committee in order to identify and attract directors conforming to the qualities enumerated heretofore.

What sources are out there? Though former and sitting CEOs and CFOs are often prime targets, they are not necessarily the most advantageous. In many cases they simply don't have sufficient time to devote to a company recovering from bankruptcy. Over boarded directors are useless. So look elsewhere, and do so persistently as there's usually a time factor. Unlikely venues sometimes yield quite valuable director candidates, particularly given the requisite expertise.

Often overlooked are highly competent executives who aren't/weren't in the C-suite. Prior or current board experience, while sometimes appropriate, isn't always as valuable as might be imagined, particularly if a candidate has an outstanding reputation for leadership in other group settings. Such "newbies" have become outstanding directors.

Age should be eliminated as a determinant. Many above the traditional 72 ceiling have more than proven their worth. Indeed, there are numerous directors over

80, as well as those under 30, with outstanding boardroom reputations. Heads of complex not-for-profit organizations with demanding constituencies can be every bit as talented as their corporate counterparts. The same holds true of certain military, governmental, legal, and academic types.

Advisers including accountants, lawyers, management consultants, and executive search firms can identify valuable board members. In short, consider proven talent wherever it may exist.

Stakeholders for the long term deserve nothing less!

About Steven A. Seiden

President, Seiden Krieger Recruiters
steven@seidenkrieger.com

Steven Seiden is experienced in recruiting directors and top executives for corporations in transition, including those emerging from bankruptcy and reorganization: Pacific Gas & Electric, Reader's Digest, Financial Guaranty Insurance, Dairy Holdings, F&W Media, Longview Power.

He has been a panelist at the New York City Bar Association as well as at other business conferences. A Yale University graduate, Steven is a member of the Turnaround Management Association, American Bankruptcy Institute, and an Associate Member of the American Bar Association.

Before founding Seiden Krieger Associates, Steven spent 17 years on Wall Street as Co-President of a successful financial services and investment banking organization.

His articles have appeared in Business Week, Bankruptcy Professional, Directors & Boards, The Journal of Corporate Renewal, The Congressional Record, The Wall Street Journal, Barron's, The Corporate Board, Business Law Today, Harvard Law School Forum on Corporate Governance, 13-D Monitor, Director's Monthly, and M&A Lawyer.

Recruiting Post-Bankruptcy Board Directors in the Pandemic Aftermath originally published by DailyDAC, reprinted here with permission.

In re Sanchez Energy Corporation
S.D. TX Bankruptcy Case No. 19-34508 (MI)

Second Amended Joint Plan of Reorganization (Docket #1198)

C. Sources of Consideration for Plan of Reorganization Distributions

The Reorganized Debtors will fund distributions under the Plan with Cash on hand on the Effective Date and the New Common Stock.

1. Issuance and Distribution of New Common Stock

   On the Effective Date, or as soon as reasonably practicable thereafter, the Reorganized Debtors shall issue the New Common Stock to fund distributions to Holders of Allowed Claims in accordance with Article III of the Plan; provided that New Common Stock issued on account of the Post-Effective Date Equity Distribution shall occur in accordance with Article IV.C.2. The issuance of New Common Stock, as well as options, or other equity awards of interests in the Reorganized Debtors, if any, reserved under the Management Incentive Plan, is duly authorized without the need for any further corporate action and without any further action by the Debtors or Reorganized Debtors or the Holders of Claims. All shares of New Common Stock issued under the Plan shall be duly authorized, validly issued, fully paid, and non-assessable.

   The Secured Ad Hoc Group shall prepare a New Stockholders' Agreement as part of the Plan Supplement. Each Entity intended to become a Holder of New Common Stock, as a condition to receiving such New Common Stock, shall be required to deliver an executed signature page to the New Stockholders' Agreement. Each Holder of New Common Stock shall be deemed a party to the New Stockholders' Agreement, without regard to whether such signature page is actually delivered. On the Effective Date, the Reorganized Debtors shall enter into and deliver the New Stockholders' Agreement to each known Entity that is intended to be a party thereto at such time, and such New Stockholders' Agreement shall be deemed to be valid, binding, and enforceable in accordance with its terms, and each Holder of New Common Stock shall be bound thereby.

2. Distribution of Post-Effective Date Equity Distribution

   The shares of New Common Stock comprising the Post-Effective Date Equity Distribution shall remain authorized but unissued pending the outcome of all or a portion of the Lien-Related Litigation, which shall occur following the Effective Date. Upon adjudication or other resolution of all or a portion of the Lien-Related Litigation, the Reorganized Debtors shall issue the Post-Effective Date Equity Distribution in the amount of New Common Stock allocated to Class 3, 4 and/or 5 Claims, to the extent such Claims are entitled to receive New Common Stock, pursuant to an order of the Bankruptcy Court. No shares of New Common Stock shall be issued on account of the Post-Effective Date Equity Distribution except as provided in an order of the Bankruptcy Court with respect to the Lien-Related Litigation, which order shall designate the allocation of New Common Stock as between the Holders of Allowed DIP Claims, if any, Holders of Allowed Secured Notes Claims, if any, and Holders of Allowed General Unsecured Claims, if any. Upon such order of allocation from the Bankruptcy Court, to the extent the New Stockholders' Agreement is not terminated in accordance with its terms, each proposed Holder of New Common Stock under such order shall, as a condition to receiving such New Common Stock, be required to deliver an executed signature page to the New Stockholders' Agreement. Each Holder shall be deemed a party to the New Stockholders' Agreement, if any, without regard to whether an executed signature pages is actually delivered.

Caution
As of: March 3, 2021 11:55 PM Z

In re Piece Goods Shops Co., L.P.

United States Bankruptcy Court for the Middle District of North Carolina, Winston-Salem Division

October 6, 1995, Dated ; October 10, 1995, ENTERED

Case No. B-93-11261 C-11W, Case No. B-93-11262 C-11W

Reporter
188 B.R. 778 *; 1995 Bankr. LEXIS 1897 **

IN RE: PIECE GOODS SHOPS COMPANY, L.P., PIECE GOODS SHOPS CORP., Debtors.

Core Terms

Reorganized, holder, confirmation, stock, common stock, liquidation, cases, voting, Disclosure, unsecured claim, Partnership, proponents, insider, unsecured creditor, preferred stock, general partner, equity value, provisions, effective date, liquidation value, convenience, impaired, subordination, affiliate, traded, confirmation hearing, best interest, ballots, fabrics, percent

Case Summary

Procedural Posture

Petitioner objected to the confirmation of debtors' plan, arguing that the plan did not meet the requirements of *11 U.S.C.S. § 1129 et seq.*

Overview

The court confirmed the plan. The court held that under *11 U.S.C.S. § 1129(a)(3)*, the plan met the "good faith" requirement. The court held that the plan was proposed in good faith because there was a reasonable likelihood that the plan would achieve a result consistent with the goals of the Bankruptcy Code. The court also held that *§ 1129(a)(10)* was satisfied. At least one impaired class voted to accept the plan because creditor was not an insider where it never exercised or threatened to exercise its voting rights. The plan did not unfairly discriminate against any class and was fair and equitable within the meaning of *§ 1129(b)*.

Outcome

The bankruptcy court confirmed the plan.

LexisNexis® Headnotes

Bankruptcy Law > Individuals With Regular Income > Plans > Cramdowns

Bankruptcy Law > ... > Plans > Plan Confirmation > General Overview

Bankruptcy Law > ... > Plans > Plan Confirmation > Cramdowns

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Fairness Requirement

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Impaired Class Consent

HN1[] **Plans, Cramdowns**

A Chapter 11 plan shall be confirmed only (i) if it meets each of the requirements set forth in 11 U.S.C.S. § 1129(a) or (ii) if § 1129(a) is satisfied in all respects except for § 1129(a)(8), which provides that each impaired class must accept the plan, and the court determines, under the "cram down" provisions of § 1129(b), that the plan does not discriminate unfairly and that its treatment of each rejecting class is fair and equitable.

Bankruptcy Law > ... > Plans > Plan Confirmation > General Overview

Evidence > Burdens of Proof > General Overview

HN2[] Plans, Plan Confirmation

The burden of proof as to confirmation rests on the Debtors and Committee as proponents of the Plan.

Bankruptcy Law > Claims > Types of Claims > Claim Classification

Bankruptcy Law > ... > Plans > Plan Confirmation > General Overview

HN3[] Types of Claims, Claim Classification

11 U.S.C.S. § 1122(a) authorizes the proponents of a plan to place claims in the same class if they are "substantially similar." The similarity of claims is not judged, as by comparing creditor claims inter se. Rather, the issue is whether the claims in a class have the same or similar legal status in relation to the debtor.

Bankruptcy Law > Claims > Types of Claims > Claim Classification

Contracts Law > ... > Priorities > Creditor Priorities > General Overview

Bankruptcy Law > ... > Plans > Plan Confirmation > General Overview

HN4[] Types of Claims, Claim Classification

Unsecured claims, whether trade, tort, unsecured notes, or deficiency claims of secured creditors, are generally included in a single class because they are of equal rank entitled to share pro rata in values remaining after payment of secured and priority claims.

Bankruptcy Law > Claims > Types of Claims > Claim Classification

Bankruptcy Law > ... > Plans > Plan Confirmation > General Overview

HN5[] Types of Claims, Claim Classification

The issue under 11 U.S.C.S. § 1122(b) is not the number of convenience classes, but whether the class is reasonable and necessary for administrative convenience.

Bankruptcy Law > ... > Plans > Plan Contents > General Overview

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Good Faith Requirement

HN6[] Plans, Plan Contents

11 U.S.C.S. § 1129(a)(3) requires that the Plan be proposed in "good faith" and not by any means forbidden by law. The requirement of good faith must be viewed in light of the totality of the circumstances surrounding the establishment of a Chapter 11 plan.

Bankruptcy Law > ... > Plans > Plan Contents > General Overview

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Good Faith Requirement

HN7[] Plans, Plan Contents

Generally, a plan is proposed in good faith if there is a reasonable likelihood that it will achieve a result consistent with the goals of the Bankruptcy Code.

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Best Interest Test

Bankruptcy Law > Reorganizations > Plans > General Overview

Bankruptcy Law > ... > Plans > Plan Confirmation > General Overview

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Impaired Class Consent

Bankruptcy Law > ... > Plans > Plan Contents > General Overview

Bankruptcy Law > ... > Reorganizations > Plans > Disclosure Statements

HN8[] **Prerequisites, Best Interest Test**

To be confirmable, a plan of reorganization must satisfy the "best interests" test under *11 U.S.C.S. § 1129(a)(7)*. The best interests test requires that each holder of a claim or interest in an impaired class accept the plan or, alternatively, receive or retain under the plan, property having a present value at least equal to what the holder would receive or retain if the debtor were liquidated under Chapter 7 on the effective date of the plan. The plan proponent must introduce sufficient current financial information about the debtor, his assets and liabilities and his prospects to permit the court to judge whether the test has been satisfied.

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Impaired Class Consent

Bankruptcy Law > Reorganizations > Plans > General Overview

Bankruptcy Law > ... > Reorganizations > Plans > Plan Acceptance

Bankruptcy Law > ... > Plans > Plan Confirmation > General Overview

Bankruptcy Law > ... > Reorganizations > Plans > Impairment of Claims

HN9[] **Prerequisites, Impaired Class Consent**

11 U.S.C.S. § 1129(a)(10) requires that at least one impaired class vote to accept the plan without regard to the vote of any insider. The court finds that there are two impaired classes, which have accepted the Plan.

Bankruptcy Law > ... > Reorganizations > Plans > Impairment of Claims

HN10[] **Plans, Impairment of Claims**

To be an "insider" under *11 U.S.C.S. § 101(31)* of the Bankruptcy Code, a creditor would have to be an "affiliate" of the Debtors or otherwise in control of the Debtors. "Affiliate" is defined under *Section 101(2)* to include an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor.

Bankruptcy Law > ... > Reorganizations > Plans > Impairment of Claims

HN11[] **Plans, Impairment of Claims**

The extent of a security holder's voting power is the appropriate measure of determining whether one is an "affiliate" of a debtor for "insider" purposes.

Bankruptcy Law > ... > Reorganizations > Plans > Impairment of Claims

Business & Corporate Compliance > ... > Contracts Law > Standards of Performance > Creditors & Debtors

HN12[] **Plans, Impairment of Claims**

A creditor is not an insider, even though the creditor has the right to elect a majority of the debtor's board of directors upon a default under the creditors' loan agreement; the compensation of the debtor's principals is subject to the creditor's approval; and the creditor holds warrants to purchase approximately 13 percent of the debtor's common stock.

Bankruptcy Law > ... > Reorganizations > Plans > Impairment of Claims

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Plan Compliance With Code

HN13[] **Plans, Impairment of Claims**

The primary objective of the exclusion of insider votes under 11 U.S.C.S. § 1129(a)(1) is to nullify the voting of a creditor who is so beholden to, or controlled by, the debtor as to be effectively an alter ego of the debtor. Where there is an affinity of interests between a creditor and the debtor, that creditor is less likely to cast a vote formed on an independent judgment of what will best serve his interests, much less those of his fellow class members.

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Feasibility Test

Bankruptcy Law > ... > Plans > Plan Confirmation > General Overview

Bankruptcy Law > ... > Plans > Plan Contents > General Overview

HN14[] **Prerequisites, Feasibility Test**

Feasibility under 11 U.S.C.S. § 1129(a)(11) means that confirmation of the Plan is not likely to be followed by liquidation. Feasibility does not require that the Plan's success be guaranteed, but only that it offer reasonable assurance of success. In assessing feasibility, the court may consider the capital structure of the reorganized Debtors, their projected earning power, economic conditions, management's ability and likelihood of continuing to work for the reorganized Debtors, and any other factors relevant to performance of the Plan.

Counsel: **[**1]** For PIECE GOODS SHOPS COMPANY, L. P., Winston-Salem, NC, Debtor: William B. Sullivan, Winston-Salem, NC. W. Joseph Burns, Winston-Salem, NC.

Judges: THE HONORABLE JAMES B. WOLFE, JR., UNITED STATES BANKRUPTCY JUDGE

Opinion by: JAMES B. WOLFE, JR.

Opinion

[*783] MEMORANDUM OPINION

Piece Goods Shop, Company, L.P., a North Carolina limited partnership which owns and operates a chain of retail stores specializing in fabrics, crafts, and related merchandise, and its general partner, Piece Goods Shops Corp., each filed voluntary chapter 11 petitions on April 19, 1993. The cases were administratively consolidated by order entered on May 12, 1993. Piece Goods Shops Company, L.P. (the "Partnership Debtor") and Piece Goods Shops Corp. (the "General Partner Debtor") (collectively, the "Debtors"), together with the Official Committee of Unsecured Creditors (the "Committee"), filed a joint Plan of Reorganization and a Joint Disclosure Statement on June 22, 1995. The Committee consists of several different types of unsecured creditors, including the co-chairman, Prudential Life Insurance Company of America ("Prudential") which, together with its affiliate Pruco Life Insurance Company, was a lender to the Debtors **[**2]** and holds the largest unsecured claim in the amount of $ 61,500,000; the other co-chairman, Butterick Pattern Company, and two other pattern suppliers, Simplicity Pattern Company and McCall's Pattern Company, NationsBank, N.A. (Carolinas) ("NationsBank"), which holds the second largest unsecured claim in the amount of $ 9,000,000 and which, like Prudential, was a **[*784]** lender to the Debtors; a fabric vendor, Springs Industries; and a factor, Bank of New York.

Of the approximately 1100 creditors in the cases, the only one to object to the Joint Disclosure Statement was NationsBank. The Debtors and the Committee made a number of modifications and additional disclosures to address NationsBank's objections. On July 20, 1995, the proponents filed a Modified Joint Plan of Reorganization (the "Plan") and Modified Joint Disclosure Statement (the "Disclosure Statement"). On the same day the Court approved the Disclosure Statement under Section 1125 of the Bankruptcy Code.

The deadline for filing objections to confirmation of the Plan was August 15, 1995. Two creditors, NationsBank and a landlord for one of the Debtors' stores, filed timely objections to confirmation. The landlord's objection was **[**3]** resolved by consent order. NationsBank filed two objections to confirmation within the August 15, 1995 deadline -- a "preliminary" objection and a detailed, thirty-three page objection. Thereafter, on August 18, 1995, NationsBank filed a document styled "Objection of NationsBank, N.A. (Carolinas) to Summary of Balloting and Inclusion of Prudential Life Insurance Company of America in Class 9 for Determining Acceptance of the Plan" which the proponents contend is a late-filed additional objection to confirmation.

The confirmation hearing was originally scheduled to commence on August 22, 1995, but was continued to August 28, 1995. In the interim, an unsuccessful effort was made to mediate NationsBank's objections to confirmation. The confirmation hearing was conducted on August 28, September 5 and 6, 1995. Extensive evidence was presented on behalf of the Plan proponents and NationsBank, including documentary evidence and testimony from eight witnesses.

At the conclusion of the hearing, the Court ruled from the bench that the Debtors and the Committee had satisfied the requirements for confirmation under *Section 1129*, overruled NationsBank's objection, and confirmed the Plan. A written **[**4]** order confirming the Plan was entered on September 7, 1995. Thereafter, NationsBank moved for relief from the confirmation order and for an extension of time to file an appeal. By consent order entered September 26, 1995, NationsBank's motions were denied with prejudice.

This opinion shall constitute the Court's findings of fact and conclusions of law in connection with the order confirming the Plan.

HISTORY

The Debtors commenced business with the opening of their first retail store in 1935 and enjoyed growth in stores, sales, and profitability until 1992 when the fabric industry fell into a recession and the Debtors encountered difficulty in servicing debt obligations incurred in connection with a leveraged buyout in 1989. By the petition date in April 1993, the Debtors' retail chain had grown to 318 stores operating in 20 states.

While operating in chapter 11, the Debtors have undergone significant changes and restructuring. A new management team is running the business. Effective January 1, 1995, the Court granted a motion filed by the Debtors and supported by the Committee to employ Mr. Gregory F. Rayburn as the Debtors' new Chairman and Chief Executive Officer. Mr. Rayburn **[**5]** is a CPA with extensive experience in advising retail and other businesses in chapter 11 proceedings. Previous to his employment by the Debtors, Mr. Rayburn had been a partner with Arthur Andersen, LLP ("Arthur Andersen") and had been in charge of the firm's representation as financial and business advisors to the Committee and the Debtors. His role as advisor to the Committee and the Debtors was filled by another Arthur Andersen partner, Mr. Richard Holmes. Other senior management changes during the reorganization, all of which were approved by the Court, include the employment of a new chief financial officer and a new merchandising director with particular experience in crafts. Mid-level management changes include a new fabrics buyer, new crafts buyer, human resources director, and tax manager.

Unprofitable stores have been identified and closed, reducing by about one-third the **[*785]** size of the Debtors' retail chain. In connection with the store closings, the Debtors conducted several Court authorized going-out-of-business sales ("GOB sales") which converted excess inventory to cash. At the conclusion of the GOB sales and following unsuccessful efforts to market the leases of the closed **[**6]** stores through assumption and assignment under *Section 365 of the Bankruptcy Code*, the Debtors rejected the leases in order to limit administrative rent claims.

The Debtors, with Arthur Andersen's assistance, have developed and implemented a new home center store (the "Home Center") which differs from the Debtors' traditional base store. The base store is typically 5000 square feet in size and focuses on selling apparel, fabrics, sewing patterns, notions and some crafts. A typical Home Center is approximately twice as large, with base store merchandise displayed in the middle to attract traditional customers and surrounded by "boutiques" of home decorating merchandise, upholstery fabrics, and basic furniture pieces, and with access to a home decorator, all designed to attract new customers. The Debtors opened their first Home Center in June 1994 and currently operate about 34 Home Centers. Sales and profits per square foot of floor space have proved to be significantly greater for Home Centers than for base stores.

Other changes made since the petition date include (i) obtaining a $ 30,000,000 post-petition financing facility from The CIT Group/Business Credit, Inc. ("CIT"), which **[**7]** requires, among other things, that the

Debtors' earnings satisfy certain minimum "EBITDA" [1] criteria, (ii) improving craft purchases and sales, (iii) acquiring point of sale registers for 30 stores which has increased management information, (iv) reducing overhead by reducing executive compensation, eliminating unfunded life insurance benefits, and ceasing to pay time-and-a-half compensation for work on Sundays, (v) improving inventory controls, and (vi) curtailing price discounting to improve margins.

THE PLAN

The Plan was jointly developed and proposed by the Debtors and the Committee. The Committee created a plan subcommittee whose members were Mr. Anthony Torre of Prudential, Mr. Sam McNeil of NationsBank, and Mr. Frank Rizzo of Simplicity Pattern Company. Term sheets were exchanged and meetings were held to negotiate the provisions of the Plan.

An important issue during negotiations **[**8]** was whether the Plan should provide that general unsecured creditors receive for their claims all of the equity in the reorganized company or whether, instead, they should receive a combination of equity and debt. The Debtors wanted an all equity plan. Mr. Holmes, the Arthur Andersen partner in charge of advising the Committee and the Debtors, also advocated an all equity plan. Prudential and NationsBank initially favored some debt, although there were differences over whether the debt should require cash payment of interest or provide for "PIK" interest, i.e., payment-in-kind interest. Initially, the Committee voted preliminarily in favor of PIK debt, subject however to a determination that the PIK interest was not taxable. After it became apparent that the PIK interest would likely be taxed, the final vote of the Committee was 6 to 1 in favor of an all equity plan. The lone dissenter was NationsBank.

Other important issues negotiated as part of the Plan were the release of subordination claims and avoidance actions, Prudential's agreeing to give up its right as the majority stockholder to elect all members of the new Board of Directors (the "Board") so that management and the other **[**9]** creditors would be assured representation on the Board, a "drag along" provision which requires that if an offer is made to purchase all of the new stock issued under the Plan, each holder must sell its shares if the offer is approved by holders of a majority of the shares (Prudential will hold a majority upon the Effective Date of the Plan) and the Board approves the offer as being in the best interests **[*786]** of the holders, and the granting to management of retention bonus and stock option rights.

The Plan provides for substantive consolidation of the Debtors. The effect is to eliminate inter-Debtor claims and cross guaranties and to eliminate duplicative claims by creditors of the Partnership Debtor who also filed claims against the General Partner Debtor based on its liability as general partner for the obligations of the partnership. Substantive consolidation results in a pooling of the assets and liabilities of the two bankruptcy estates. In these cases, the General Partner Debtor has material asset other than its equity interest in the Partnership Debtor, and all claims against the General Partner Debtor, except the claim of the Internal Revenue Service ("IRS"), are based on its **[**10]** derivative liability as general partner for the debts of the Partnership. The IRS has filed a proof of claim in the General Partner Debtor's case, but not in the Partnership Debtor's case. In the absence of substantive consolidation, the IRS may nevertheless have been able to recover from the Partnership Debtor's estate because the Partnership Debtor routinely transferred funds to the General Partner Debtor to pay taxes to the IRS and because tax refunds, including a $ 1,700,000 refund during the reorganization cases, were paid by the IRS to the General Partner Debtor which thereafter transferred them to the Partnership Debtor. Substantive consolidation gives the IRS an unquestioned claim against the assets of the Partnership. The Court finds that any negative impact on creditors holding claims against the Partnership Debtor by having the IRS claim added to the pooled assets and liabilities is offset by the benefit of substantive consolidation in preserving the partnership structure and net operating losses totalling approximately $ 18,000,000, which losses may be used against future earnings to reduce future tax liability. No creditor or other party in interest, including NationsBank, **[**11]** raised a timely objection to the Plan's provision for substantive consolidation.

The Plan contemplates substantial reinvestment of capital in the business, primarily to continue conversions of base stores into Home Centers and to acquire better management information systems. The Debtors have a commitment letter from Heller Financial for a $ 20,000,000 exit financing facility which is needed to effectuate the Plan. The effective date of the Plan is the later of October 31, 1995, or the last day of the calendar

[1] "EBITDA" is an accounting acronym which stands for "Earnings Before Income, Taxes, Depreciation and Amortization."

month in which the exit financing facility becomes available to the reorganized Debtors. The Plan provides that the final terms and conditions of the facility shall be submitted to the Court for approval upon notice and hearing.

The Plan classifies all claims and interests into eleven (11) separate classes. Classes 1, 2, 3, 4, 5, 6, 7B, 8, and 10 are not impaired. Those classes provide for the treatment of administrative expenses, including CIT's administrative claim and reclamation claims; wage and benefit claims; tax claims; the claim of The Independent Order of Forresters secured by a deed of trust on the Debtors' warehouse and distribution center; unsecured claims of $ **[**12]** 200 or less; certain long-term standing debit claims of pattern suppliers, and the interests of the General Partner Debtor and its wholly owned subsidiary, PG-Sub, Inc., as partners of the Partnership Debtor. NationsBank's objections to confirmation do not concern these unimpaired classes, and the Court finds that they satisfy the requirements of Section 1129 of the Bankruptcy Code.

The impaired classes are, as follows:

1. *Class 7A.* This class covers convenience claims greater than $ 200 and less than $ 2,500 in amount. The treatment proposed for each holder of an allowed claim in Class 7A is payment in cash of the greater of $ 200 or fifty percent (50%) of the allowed amount of the claim. Utilities which fall into this class are required to apply against their claims any post-petition deposits which they received in accordance with Section 366 and to refund the balance, if any.

2. *Class 9.* This is the class which treats the claims of all general unsecured creditors other than those covered by the convenience classes. It provides that each holder of an allowed claim in Class 9 shall receive in full satisfaction thereof one (1) share of new common stock (the "New Common Stock") **[**13]** in the **[*787]** reorganized General Partner Debtor (hereinafter the "Reorganized Company") for each one hundred dollars ($ 100) of the allowed claim amount. The Plan does not provide for fractional shares to be issued. In distributing shares of stock to Class 9 creditors, all enforceable, contractual subordination agreements between creditors will be honored, including Prudential's agreement to subordinate a portion of its claim to that of NationsBank.

3. *Class 11.* Class 11 covers all of the common and preferred stock in the General Partner Debtor and proposes that all such interests be terminated, cancelled, and extinguished. Because the General Partner Debtor's existing stockholders are to receive nothing for those interests under the Plan, Class 11 is deemed to have rejected the Plan under Section 1126(g) of the Bankruptcy Code.

CONFIRMATION REQUIREMENTS

HN1[] A chapter 11 plan shall be confirmed only (i) if it meets each of the requirements set forth in Section 1129(a) or (ii) if Section 1129(a) is satisfied in all respects except for subparagraph (8) which provides that each impaired class must accept the plan and the Court determines, under the "cram down" provisions of Section 1129(b), **[**14]** that the plan does not discriminate unfairly and that its treatment of each rejecting class is fair and equitable. *In re Guilford Telecasters, Inc.,* 128 Bankr. 622, 625-26 (Bankr. M.D.N.C. 1991). HN2[] The burden of proof as to confirmation rests on the Debtors and Committee as proponents of the Plan. *In re Locke Mill Partners,* 178 Bankr. 697, 700 (Bankr. M.D.N.C. 1995).

The Court finds that the Plan satisfies each of the applicable confirmation requirements of Section 1129(a), except for subparagraph (8) insofar as the impaired class of interests in Class 11 is deemed to have rejected the Plan. With respect to Class 11, the Court finds that the Plan does not discriminate unfairly and is fair and equitable within the meaning of Section 1129(b). *See In re Guilford Telecasters, Inc.,* 128 Bankr. 622, 627 (Bankr. M.D.N.C. 1991).

Certain subparagraphs of Section 1129(a) do not apply to these cases, including Section 1129(a)(6) dealing with government rate regulation and Section 1129(a)(13) dealing with retiree benefits within the meaning of Section 1114. Other subparagraphs are satisfied without objection by NationsBank. These include that the proponents of the Plan comply with the **[**15]** applicable provisions of title 11 (Section 1129(a)(2)); that the Court approve as reasonable any payments made or promised by the Debtors, the Committee, or by a person issuing securities or acquiring property under the Plan for services or costs and expenses relating to these cases or to the Plan (Section 1129(a)(4)), that the officers and directors of the Reorganized Company and the affiliates of the Debtors participating in a joint plan have been disclosed, that the appointment of the officers and directors is consistent with the interests of creditors, equity holders, and public policy, and that insiders proposed to be employed or retained by the reorganized

Debtors and the nature of their compensation have been disclosed (Section 1129(a)(5)); that the Plan proposes appropriate treatment of priority claims (Section 1129(a)(9); and that all fees payable under section 1930 of title 28 have been paid or will be paid by the effective date of the Plan (Section 1129(a)(12)).

NATIONBANK'S OBJECTIONS

NationsBank contends that the Plan violates Section 1122(a) by including Prudential's claims in Class 9 with the claims of NationsBank and other general unsecured creditors and violates **[**16]** Section 1122(b) by proposing a second convenience class in Class 7B. Although not couched as such, these are objections to confirmation under Section 1129(a)(1) which requires that the Plan comply with the provisions of title 11. NationsBank also objects that the Plan violates Section 1123(a)(4) by not providing "equal treatment" of claims and therefore fails to satisfy the confirmation requirement of Section 1129(a)(1). NationsBank objects that the Plan has not been proposed in "good faith" as required by Section 1129(a)(3) because unsecured claims will not receive debt obligations in addition to all of the New Common Stock in the Reorganized Company. Finally, **[*788]** NationsBank objects that Section 1129(a)(7) has not been satisfied because the Plan fails the "best interests" of creditors test and because Prudential will control the Board of Directors of the Reorganized Company.

Even though NationsBank did not file a timely objection to confirmation on the ground that no impaired class, excluding insiders, has accepted the Plan as required by Section 1129(a)(10) or on the ground that the Plan is not "feasible" as required by Section 1129(a)(10), it argued both issues at the confirmation **[**17]** hearing. Moreover, NationsBank filed an objection after the August 15 deadline alleging that Prudential is an "insider" whose vote should not be counted for purposes of Section 1129(a)(10). The proponents carry the burden of proof with respect to confirmation. Accordingly the Court will detail its findings that the Plan meets the requirements of Section 1129(a)(10) and Section 1129(a)(11).

CLASSIFICATION OF CLAIMS

The Plan appropriately includes all general unsecured claims [2] in a single class -- Class 9. Section 1122(a) HN3[] authorizes the proponents of a plan to place claims in the same class if they are "substantially similar." The similarity of claims is not judged, as NationsBank contends, by comparing creditor claims *inter se*. Rather, the issue is whether the claims in a class have the same or similar legal status in relation to the debtor. *E.g.,* *In re AOV Industries, Inc., 253 U.S. App. D.C. 186, 792 F.2d 1140, 1150 (D.C. Cir. 1986)*. HN4[] Unsecured claims, whether trade, tort, unsecured notes, or deficiency claims of secured creditors, are generally included in a single class because they are "of equal rank entitled to share pro rata in values remaining after payment of secured **[**18]** and priority claims." *FGH Realty Credit Corp. v. Newark Airport/Hotel Limited Partnership,* 155 Bankr. 93 (D.N.J. 1993).

Prudential's claim based upon its unsecured promissory notes is "substantially similar" to the claims of NationsBank, trade creditors, factors, landlords with lease rejection claims, utilities, and other unsecured creditors included in Class 9. All such claims have the same legal status in relation to the Debtors and are of equal rank entitled to share pro rata in the values remaining after payment of secured and priority claims. It matters not that Prudential's notes provide for payment of interest (NationsBank's claim is also based upon an interest bearing debt instrument), that Prudential's unsecured claim arises from its financing in 1989 of a leveraged buyout of the Debtors, that Prudential also is the holder of preferred stock and class B common stock (all of which stock is extinguished under the Plan), or that Prudential **[**19]** agreed to subordinate a portion of its unsecured claim to the unsecured claims of NationsBank. These factors do not place Prudential's unsecured claim in a rank or status different from other unsecured claims vis-a-vis the Debtors. Plan proponents are to be given considerable discretion in classifying claims according to the facts and circumstances of their cases. *In re Holywell Corp., 913 F.2d 873, 880 (11th Cir. 1990)*. Here the Debtors and the Committee were within their discretion in deciding to include Prudential's unsecured claim with the unsecured claims of other creditors in Class 9.

NationsBank's other objection relating to claims classification concerns the creation of Class 7A, a second convenience class for claims greater than $ 200 and less than $ 2,500. NationsBank first argues that by its terms Section 1122(b) prohibits a plan from having more than one convenience class. The statute contains no such prohibition. The same argument was rejected by the court in *In re Jartran,* 44 Bankr. 331 (Bankr.

[2] Excluding general unsecured claims in the convenience classes.

N.D.Ill. 1984). In that case, the court approved two convenience classes, one providing for payment in full on the effective date of all claims less than $ 500 and the **[**20]** other providing for stretched out payments of all claims between $ 500 and $ 2500.

HN5[] The issue under *Section 1122(b)* is not the number of convenience classes, but whether Class 7A is reasonable and necessary for administrative convenience. Mr. Rayburn testified that the reason for creating Class 7A was to reduce the number of creditors who receive New Common Stock **[*789]** below 500 so that the stock would not have to be publicly registered. Based upon his experience in working for public companies, Mr. Rayburn knew of the costs involved in being subject to securities regulations, including the filing of 10-K and 10-Q reports, and desired for the reorganized Debtors to avoid those costs. There is no evidence to support NationsBank's contention that Class 7A was designed to avoid the scrutiny of federal regulators. Nor is there any evidence to support NationsBank's contention that Class 7A was intended by the Plan proponents to gerrymander voting and create an impaired accepting class. Of the approximately 1100 unsecured claims in these cases, the convenience classes cover about 800, leaving 300 larger unsecured claims for treatment with equity distribution under Class 9. Thus, the convenience **[**21]** classes serve the purpose of allowing the reorganized Debtors to avoid the trouble and expense of complying with public registration requirements. Moreover, Mr. Rayburn estimated that the Debtors will pay about $ 200,000 in satisfaction of all 800 convenience claims, an amount which the Court finds to be reasonable and necessary in the circumstances of these cases.

EQUAL TREATMENT OF CLAIMS

NationsBank contends that the Plan does not provide equal treatment to all creditors in Class 9. The Court disagrees. The Plan provides that each holder of an allowed claim in Class 9 shall receive one share of New Common Stock for each $ 100.00 of allowed claim. Moreover, as to subordinated claims, the Plan expressly provides that inter-creditor subordination agreements will be enforced, resulting in the allocation of distributions otherwise payable on account of subordinated claims to holders of senior claims, specifically Prudential and NationsBank. As a result of the *pro rata* equity distribution under the Plan and after giving effect to the subordination provisions described above, Prudential will hold approximately 54 percent, or a majority, of the New Common Stock in the Reorganized **[**22]** Company.

NationsBank, however, argues that the effect of the so-called "drag-along" and release provisions under the Plan is to yield additional value for Prudential alone. The "drag-along" provision is at Article IV, Section 4.1(e) of the Plan, entitled "Offer to Purchase All Stock under the Plan." It is not part of the treatment of claims, but rather, a negotiated corporate governance provision which will be included in the Reorganized Company's certificate of incorporation. It requires all shareholders to sell their common stock in an offer received and approved by a holder of the majority of the Reorganized Company's common stock and the board of directors of the Reorganized Company.

Articles IV and XIII of the Plan, entitled "Provisions of Equity Securities To Be Issued Pursuant to the Plan" and "Officers and Directors of Reorganized Company," respectively, contain numerous corporate governance provisions which were negotiated among members of the Committee and the Debtors to achieve the consensus which is the foundation of the jointly proposed Plan. These include, in addition to the so-called drag-along provision, restrictions on Prudential's rights to vote for directors of **[**23]** the Reorganized Company so that other creditors and management are assured of representation. Such provisions are consistent with *Section 1123(a)(5)* which contemplates "amendment of the debtor's charter" as one of the means of implementing the agreements embodied in a plan.

The corporate "governance provisions of Articles IV and XIII of the Plan represent a give and take among Committee members and the Debtors. Absent these provisions, Prudential, as majority shareholder, could control the vote for all five directors of the Reorganized Company. Instead, Prudential has relinquished its voting rights with respect to certain Board seats, assuring non-Prudential shareholders and management four of the five seats during the first year after consummation of the Plan and assuring non-Prudential shareholders one seat thereafter. These provisions, which represent an accommodation by Prudential to the Committee and the Debtors, along with the "drag-along" provision, were included in the Plan as part of the consensus reached on corporate governance.

[*790] Although the corporate governance provisions of the Plan may affect shareholders of the Reorganized Company, they do not change the fact that all **[**24]** Class 9 creditors receive *pro rata* distributions of the stock of the Reorganized Company. In any case where the plan converts unsecured claims to equity and a single creditor's claim represents more than half of the total claims, that creditor will have the benefits of control, *i.e.*, to select directors, approve mergers, etc. However, these special control benefits flow not from "unequal treatment" of claims, but rather from the natural consequences of corporate law. *See e.g., Delaware* General Corporation Law § 251(c). Accordingly, non-economic attributes of equity ownership should not be germane to the analysis of equality of treatment under *Section 1123(a)(4) of the Bankruptcy Code*. Otherwise, it would be impossible to confirm any plan under which a creditor receives a controlling percentage of the stock of a reorganized corporate debtor. It is clear that this is not the case, and at least one court has held that provisions of a plan regarding control or management of the reorganized debtor which affect members of the same class differently are irrelevant to the test for equality of treatment under *Section 1123(a)(4) of the Bankruptcy Code*. *See* *Acequia, Inc. v. Clinton [**25] (In re Acequia, Inc.), 787 F.2d 1352 (9th Cir. 1986)*.

NationsBank also argues that Prudential, and no other Class 9 creditor, will benefit from the general compromise, settlement and release of equitable subordination claims under the Plan. The Court, however, does not believe that the release provisions of Article XI of the Plan violate the equality of treatment requirements of *Section 1123(a)(4)*. The Plan provides not only a release of equitable subordination claims, but also a release of preference and other avoidance actions, all of which are equally applicable to all creditors. Prudential is not singled out as a beneficiary. Indeed, in the case of Prudential, both the Debtors and the Committee have made the determination that there is not a sufficient factual or legal basis to pursue any kind of equitable subordination claim. *See* Disclosure Statement at pp. 36-37. NationsBank did not put forth any authority or introduce any evidence or testimony that refuted the conclusions reached by the Debtors and the Committee.

GOOD FAITH

Section 1129(a)(3) ***HN6***[] requires that the Plan be proposed in "good faith" and not by any means forbidden by law. The requirement of good faith must **[**26]** be viewed in light of the totality of the circumstances surrounding the establishment of a chapter 11 plan. *In re Block Shim Development Company-Irving, 939 F.2d 289 (5th Cir. 1991)*. ***HN7***[] Generally, a plan is proposed in good faith if there is a reasonable likelihood that it will achieve a result consistent with the goals of the Bankruptcy Code. *Hanson v. First Bank of South Dakota, N.A., 828 F.2d 1310 (8th Cir. 1987)*. The primary goal of chapter 11 is to promote the restructuring of the debtor's obligations so as to preserve the business and avoid liquidation. *See* *NLRB v. Bildisco and Bildisco, 465 U.S. 513, 104 S. Ct. 1188, 79 L. Ed. 2d 482 (1984)* ("The fundamental purpose of reorganization is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources."). The Plan proposed by the Debtors and the Committee accomplishes this goal by providing the means through which the Debtors may continue to operate as a viable entity in the marketplace.

NationsBank objects that the Plan was not proposed in good faith because it fails to include debt repayment to unsecured creditors in Class 9 even though the Debtors' business **[**27]** plan and projections allegedly reflect an ability to repay at least some of the debt over time. The authority relied upon by NationsBank -- *In re Walker*, 165 Bankr. 994 (E.D. Va. 1994) -- is inapposite. In *Walker,* the debtors were solvent and proposed a plan which deferred any payment to secured creditors, failed to provide a schedule of asset liquidations which were needed to fund the plan, and permitted the debtors to maintain a lavish lifestyle. By contrast, the Debtors in these cases are insolvent, with a going concern value estimated at $ 31.5 million (a value which NationsBank maintains is too high) and unsecured liabilities of **[*791]** approximately $ 102 million. Further, unlike *Walker,* the Plan does not sacrifice the interests of creditors for the benefit of the Debtors. Rather, the Plan proposes to extinguish the interests of the existing equity holders and give the entire value of the Debtors to the creditors in the form of cash payments to secured, priority and convenience creditors and of distributions of all the New Common Stock to general unsecured creditors in Class 9. Moreover, the fact that the Plan is proposed by the Committee as well as the Debtors is strong evidence **[**28]** that it is proposed in good faith.

The position which NationsBank takes in its objection, namely, that the Plan must provide for general unsecured creditors to receive debt obligations in addition to all of the stock in the reorganized Debtors, is the same position which it took during negotiations on the Plan and which was rejected by Prudential and the other five creditors on the Committee, by the professional advisors to the Committee and the Debtors, and by the Debtors. Among the reasons the proponents' witnesses gave for favoring an all equity Plan were to avoid the taxation problem with PIK debt, provide more cash for reinvestment in the business, increase the Debtors' ability to perform the business plan, obtain more vendor and factor support, and enhance the value of the stock. In addition, Mr. Rayburn testified that Heller Financial, which has committed to provide exit financing for the Plan, was unwilling to have those funds used to pay principal or interest on debt owed to unsecured creditors. The Court finds that the Plan was proposed in good faith as required by *Section 1129(a)(3)*, and NationsBank's objection in this regard is overruled.

BEST INTERESTS TEST

HN8[] To be confirmable, **[**29]** a plan of reorganization must satisfy the "best interests" test under *Section 1129(a)(7)*. *E.g., In re Neff,* 60 Bankr. 448, 452 (Bankr. N.D.Tex. 1985), *aff'd, 785 F.2d 1033 (5th Cir. 1986)*. The best interests test requires that each holder of a claim or interest in an impaired class accept the plan or, alternatively, receive or retain under the plan property having a present value at least equal to what the holder would receive or retain if the debtor were liquidated under chapter 7 on the effective date of the plan. The plan proponent must introduce sufficient current financial information about the debtor, his assets and liabilities and his prospects to permit the court to judge whether the test has been satisfied. *Id.*

The Debtors and the Committee presented extensive evidence at the confirmation hearing bearing on the best interests test. Likewise, NationsBank devoted much of its evidence to this issue. The Court finds that the best interests test under *Section 1129(a)(7)* is met as to each holder of a claim or interest in the three impaired classes under the Plan -- Class 7A, Class 9, and Class 11. None of those classes voted unanimously to accept the Plan. However, **[**30]** each holder in the classes will receive under the Plan at least as much as it would receive in a liquidation.

1. Equity Value

The Disclosure Statement estimates the equity value of the reorganized Debtors to be $ 31.5 million. Mr. Holmes of Arthur Andersen testified that he determined the equity value set forth in the Disclosure Statement. He used a market multiple approach to derive the Debtors' value based upon the value of their two closest market comparables, Hancock and Fabricenter. Both Hancock and Fabricenters are publicly traded companies. Mr. Holmes determined from Value Line and other information sources that Hancock was trading at a multiple of EBITDA slightly above 10 and that Fabricenter was trading at a multiple of EBITDA slightly above 7. Considering Fabricenter to be a closer comparable, he determined that it was appropriate to use a multiple of 7 for the Debtors. He applied the multiple to the Debtors' projected EBITDA of approximately $ 4.8 million. After consulting with his partner Mr. Steven Matt, who specializes in formal appraisals of businesses, including stock values, Mr. Holmes determined to offset a projected increase in the seasonal draw on the Debtors' **[**31]** line of credit against a corresponding increase in working capital inventory. **[*792]** Finally, Mr. Holmes deducted secured debt of $ 2.1 million to produce the equity value of$ 31.5 million.

At the confirmation hearing, Mr. Holmes testified that his opinion of the equity value had not changed since preparation of the Disclosure Statement. Following NationsBank's objection, Mr. Holmes requested Mr. Matt to test the reasonableness of the $ 31.5 million figure. Mr. Matt performed a more extensive market multiple analysis, using the quoted stock prices for Hancock and Fabricenters for August 9, 1995, August 24, 1995, and a 30-day average period ending August 24, 1995. Based upon that analysis, which is summarized in Exhibit 12, Mr. Matt determined that the equity value of the reorganized Debtors ranged between $ 31.3 and $ 33.0 million. In his opinion, $ 31.5 million was a reasonable estimate of the equity value. Mr. Rayburn also concurred with Mr. Holmes' opinion of the equity value. Mr. Torre, who has extensive experience in valuing businesses for Prudential, viewed the equity value of the reorganized Debtors as exceeding $ 31.5 million. In addition, Messrs. Holmes and Matt each expressed the **[**32]** opinion that the reorganized Debtors would likely sell for more than their $ 31.5 million equity value because of a control premium of at least 20 percent.

Mr. Holmes testified that the equity value of the Reorganized Company translates into a value of $ 31.50 for each share of New Common Stock to be issued to Class 9 creditors. There are approximately $ 100,000,000 of unsecured claims in Class 9. Because the Plan provides that 1 share will be distributed for each $ 100 of claims, it is anticipated that Class 9 creditors will receive a total of 1,000,000 shares. Mr. Holmes divided the total shares into the equity value of $ 31.5 million to determine the value per share in the hands of each holder. The per share value of $ 31.50 will not be diluted by the Plan's management stock option program which could result in distribution of up to an additional 100,000 shares, because to buy stock under the program, management must pay into the Reorganized Company an option price equal to $ 31.50 per share.

According to Mr. Holmes, there are three general levels of stock value: (1) control value, (2) freely traded minority value, and (3) closely held value. The stock prices for Hancock and Fabricenter, **[**33]** which he used in valuing the New Common Stock, represent freely traded minority values. By contrast, the New Common Stock will not be publicly traded when distributed on the Effective Date. This lack of marketability suggests some discount in value from the freely traded minority values of Hancock and Fabricenter. However, because claims have traded in these cases and based upon his experience in other chapter 11 cases, Mr. Holmes believes that a secondary market will be created for trading in the New Common Stock. For that reason, he views the lack of marketability discount as being smaller than if the New Common Stock were closely held with little or no trading. In addition, Mr. Holmes considers the lack of marketability discount to be offset by the possibility that the Debtors are sold after the effective date and, through the "drag along" provision, the control premium is realized by all shareholders, including those with minority interests. Based on these and other considerations, Mr. Holmes concluded that the value to holders of $ 31.50 per share is not reduced by the fact that the New Common Stock will not be publicly traded on the effective date of the Plan. Mr. Matt reached **[**34]** the same conclusion.

The Court accepted Mr. Holmes as an expert to render opinions regarding the best interests test of *Section 1129(a)(7)*, including equity and liquidation values. He is the national director of the bankruptcy group at Arthur Andersen, has more than 20 years of experience in the bankruptcy field, is a certified insolvency and reorganization accountant, and is a fellow of the American College of Bankruptcy. He has provided professional services to clients in more than 500 bankruptcy cases, including other fabric and craft retail cases, and has testified as an expert on equity and liquidation values under the best interests test in more than 100 cases. Mr. Matt qualified as an expert to render opinions regarding equity values of businesses, including valuation of securities. Mr. Matt is a professional business appraiser who has rendered both formal appraisals and **[*793]** estimates of values. He has appraised the value of securities in more than 100 cases. He is an accredited senior appraiser with the American Society of Appraisers. Based upon their credentials as experts and the nature and substance of their testimony, the Court gives great weight to the expert opinions of **[**35]** Messrs. Holmes and Matt.

Although NationsBank raised a number of objections to the methodology employed and conclusions reached by the proponents' valuation experts, it offered no persuasive evidence or expert opinion of a different equity value for the Reorganized Company or of a different value for the New Common Stock in the hands of Class 9 creditors. NationsBank's principal witness in this regard was Mr. W. Allen Rogers. The Court recognized Mr. Rogers as an expert in valuing securities, but the weight of his opinion testimony is limited by the fact that he has no experience in valuing securities issued under a chapter 11 plan and that he spent relatively little time learning about the Debtors and their reorganization cases. For example, Mr. Rogers criticized the proponents' experts for using Hancock and Fabricenters as comparables because he believed they had "experienced management" unlike the Debtors. However, through cross-examination, it became evident that Mr. Rogers knew virtually nothing about the Debtors' management team, let alone their level of experience. He also admitted that "you [i.e., the proponents] have probably used the only decent -- available comparables **[**36]** that you can," and then immediately retracted the testimony, stating instead that Hancock and Fabricenter were not the best comparables. Mr. Rogers offered no opinion as to which company or companies would be better comparables. Finally, the Court does not agree with Mr. Rogers' opinion that the best method for valuing what holders in Class 9 will receive under the Plan is to determine the break-up, liquidation value of the Reorganized Company.

Mr. McNeil, NationsBank's representative on the Committee, testified that during the course of the contested confirmation proceedings, the bank invited bids to see what price its claim would bring. NationsBank did not explain or comment on the contested confirmation proceedings to any of the brokers or potential bidders. Brokers and bidders were left to speculate for themselves. The deadline for submitting bids was the Friday before a three-day holiday weekend. No negotiations were conducted with respect to the bids. The Court finds that this "bidding" of NationsBank's claim does not reasonably reflect the value of New Common Stock to be distributed to Class 9 creditors. More probative of value is Mr. McNeil's statement to Mr. Rayburn around **[**37]** the time of the Disclosure Statement hearing that NationsBank would not consider selling its claim for less than 30 cents on the dollar.

Based on all the evidence, the Court finds that the Debtors and the Committee have established that the value of the New Common Stock to be distributed to Class 9 creditors is $ 31.50 per share which represents a return on claims of 31.5 percent.

2. Liquidation Value

The Disclosure Statement contains an analysis of the value to unsecured creditors in the event the Debtors were liquidated under chapter 7 as of an assumed effective date of August 26, 1995. The analysis includes an estimate of the proceeds to be realized from inventory and other assets including potential recoveries from preference actions, accounts for the payment of secured debt, and estimates liquidation costs, post-petition current liabilities, and administrative and priority claims. Under this analysis the net assets available to unsecured creditors in a liquidation is $ 16.8 million, and the percentage recovery to unsecured creditors is 14.9 percent.

The liquidation analysis in the Disclosure Statement was prepared by Mr. Michael Callahan, a manager at Arthur Andersen. Mr. **[**38]** Callahan has worked for the Committee and the Debtors in these cases since Arthur Andersen was first retained in June, 1993. He was supervised by the partners on the engagement -- Mr. Rayburn and his successor, Mr. Holmes. Mr. Callahan's experience with the Debtors includes store closings and related GOB sales which have been conducted **[*794]** during these reorganization cases. Mr. Callahan is a certified public accountant with experience in the field of bankruptcy, including experience in preparing and reviewing liquidation analyses in chapter 11 cases. The Court recognized Mr. Callahan as an expert regarding liquidation analyses in reorganization cases.

Mr. Callahan testified at the confirmation hearing concerning the liquidation analysis in the Disclosure Statement and a sixteen-page supporting summary of his calculations and methodology which was admitted in evidence as Exhibit 9. In its written objection to confirmation and in its deposition of Mr. Callahan, NationsBank raised a number of questions concerning the liquidation analysis in the Disclosure Statement. Thereafter, Mr. Callahan spent approximately five days evaluating NationsBank's objections and doing further work to refine **[**39]** his liquidation analysis. At the confirmation hearing, Mr. Callahan gave his opinion as to those objections which he believed had validity and those which did not. He acknowledged that the figures he used in the Disclosure Statement for store level expenses and the liquidator's commission were too high. However, he disagreed with NationsBank's contention that the figures were too high for a physical inventory by RGIS, for administrative fees, and for satisfying the IRS's priority claim, and he explained the reasons for his disagreement. Mr. Callahan also explained other refinements which he believed would be appropriate to update the liquidation analysis, some of which involved points not raised by NationsBank. Taking all of these adjustments and refinements into account, Mr. Callahan gave his opinion that the net recovery to unsecured creditors in the event of a chapter 7 liquidation would be $ 17.7 million, or a percentage recovery on claims of 15.9 percent. Mr. Holmes, the Arthur Andersen partner who supervised Mr. Callahan, testified that he reviewed and approved the liquidation analysis and that he agreed with Mr. Callahan's opinion regarding liquidation value.

NationsBank's **[**40]** principal witness on the issue of liquidation value was Mr. Alan Glazer. The Court accepted Mr. Glazer as an expert qualified to give opinion testimony in the field of liquidation, reorganizations and financial workouts. Mr. Glazer did not give an opinion of the liquidation value of the Debtors. Instead, his testimony focused on criticizing certain aspects of Mr. Callahan's analysis. Mr. Glazer proposed specific "savings" in a liquidation totalling $ 4.9 million as well as other unspecified savings that could push the total to $ 10.0 million. The Court does not find Mr. Glazer's criticisms to be persuasive except insofar as they were recognized and accounted for by Mr. Callahan in his adjusted liquidation value of $ 17.7 million. Mr. Glazer was of the opinion that lease cancellation expense would be less than what Mr. Callahan included in his analysis. He assumed that ten percent of the expense would be mitigated by assigning the Debtors' store locations to other lessees. However, that assumption is belied by the Debtors' actual experience trying to assign the store locations which were closed during these cases. Despite considerable effort, not a single assignee was obtained for any **[**41]** of the locations. The Court also rejects Mr. Glazer's assumption that a professional liquidator would charge a two and one half percent (2.5%) commission and finds that it is more reasonable to assume, as Mr. Callahan did, that the liquidator's commission would be three percent (3.0%.) which equals the actual commission charged by the professional liquidator in these cases in connection with GOB sales. Finally, Mr. Glazer's opinion that August 26, 1995 would be the "wrong time to liquidate" and that a higher recovery could be achieved if the liquidation were deferred until December or January is not helpful to the Court in determining the liquidation value under *Section 1129(a)(7)* for confirmation of this Plan. Although it may have been more appropriate for the proponents of the Plan to choose a hypothetical effective date in September rather than August, it would not have been appropriate to assume that the effective date would be deferred until December or January. There is no evidence that the recovery to unsecured creditors would change materially if a chapter 7 liquidation were conducted in September rather than August. Moreover, at least some of the delay in confirming and effectuating **[**42]** the Plan **[*795]** is due to NationsBank's objections to confirmation and its motions for relief from the confirmation order and for extension of time to appeal. The proponents of the Plan are not required to anticipate that delay in projecting a hypothetical effective date for purposes of Section 1120(a)(7).

3. Conclusion

Based on all the evidence, the Court finds (i) that the equity value of the Reorganized Company and the value of the New Common Stock is $ 31.5 million, (ii) that the value of a share of New Common Stock to each holder of a Class 9 claim is $ 31.50, or a percentage recovery on claims of 31.5%, and (iii) that the liquidation value to unsecured creditors is in the range of $ 16.8 to $ 17.7 million, or a percentage recovery on claims of 14.9% to 15.9%. Because each holder of a Class 9 claim will receive stock under the Plan worth significantly more than its share of the liquidation value, the Court finds that the best interests test of *Section 1129(a)(7)* is met as to that class. With respect to Class 7A, each holder will receive under the Plan a cash payment upon the effective date of no less than 50% of its claim. This clearly exceeds the liquidation value and *Section 1129(a)(7)* **[**43]** is satisfied as to Class 7A. Holders of interests in Class 11 will receive no property under the Plan, but neither would they receive anything in a chapter 7 liquidation. Accordingly, the Court finds that *Section 1129(a)(7)* is satisfied as to Class 11.

IMPAIRED ACCEPTING CLASS

HN9[] *Section 1129(a)(10)* requires that at least one impaired class vote to accept the plan without regard to the vote of any insider. The Court finds that there are two impaired classes which have accepted the Plan, namely Class 7A and Class 9. According to the Summary of Voting on the Plan of Reorganization as corroborated by the testimony of Mr. Rayburn, there were 108 acceptances and only 9 rejections in Class 7A. In terms of claim amounts, acceptances totalled $ 97,786 and rejections totalled $ 13,629. Thus, Class 7A voted to accept the Plan by approximately 92% in number and 88% in amount, far exceeding the minimum requirements for acceptance set forth in *Section 1126*. As indicated above, the Court finds that Class 7A is a proper impaired class and was not created by the Debtors and the Committee to gerrymander voting and assure compliance with *Section 1129(a)(10)*.

Likewise, the evidence establishes that voting **[**44]** by Class 9 creditors comfortably exceeds the minimum requirements for acceptance under *Section 1126*. Irrespective of amended ballots, there were 144 acceptances and 38 rejections in Class 9. In terms of claim amounts without regard to amended ballots, acceptances totalled $ 79,942,021 and rejections totalled $ 17,901,414. Counting amended ballots, the total for acceptances would increase to $ 80,125,998 and the total for rejections would decrease to $ 17,790,562. In a letter which NationsBank sent to all Class 9 creditors and introduced as Exhibit 6 at the confirmation hearing, the statement is made that "if you have already returned a ballot accepting the plan, you may change your vote by returning an amended ballot." This advice to creditors is erroneous. Ballots, once cast, may not be changed or withdrawn without the Court's permission, for cause shown, after notice and hearing in accordance with *Bankruptcy Rule 3018*. No party has sought the Court's permission to change any ballot on the Plan. Accordingly, the amended ballots will not be counted. The Court notes that if the amended ballots were counted, the effect would be to increase the margin of acceptance by Class 9. As it is, **[**45]** Class 9 voted to accept the Plan by approximately 79% in number and 82% in amount.

NationsBank has asserted that Prudential (including its affiliate Pruco Life Insurance Company) are "insiders" of the Debtors and that, therefore, their respective votes in favor of the Plan must be excluded under *Section 1129(a)(10)* in determining whether Class 9 creditors have accepted the Plan. Based upon the evidence and applicable legal authority, the Court finds that Prudential is not an "insider."

HN10[] To be an "insider" under *Section 101(31) of the Bankruptcy Code*, Prudential would have to be an "affiliate" of the Debtors or otherwise in control of the Debtors. "Affiliate" is **[*796]** defined under *Section 101(2)* to include "an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor . . . ."

Although NationsBank argues that "Prudential has the voting power to control a full 33% of the pre-petition board of directors of Piece Goods Shops Corp. (the "Company") and that this power is in addition to its control of 35% of the Reorganized Company's Common Stock," an analysis of Prudential's holdings and the evidence **[**46]** before the Court establish that Prudential, although an equity holder in the Company, did not own any "voting securities" that could give it the voting power to render it an affiliate nor did it ever control any member of the Company's pre-petition board of directors.

Prudential's holdings are described in that certain Note and Stock Purchase Agreement, dated February 7, 1989 (the "Agreement"), under which Prudential purchased various issues of debt securities of the Partnership of which approximately $ 61 million in principal remains outstanding (the "Notes"). The Company guaranteed payment of the Notes. Under the Agreement, Prudential also purchased 100% of the issued and outstanding shares of the Class B Common Stock of the Company (the "Class B Stock") and the 10% PIK Preferred Stock of the Company (the "Preferred Stock"). The Class B Stock represents 35% of the common stock of the Company. The other 65% is comprised of Class A Common Stock. Significantly, Prudential does not own any shares of the Company's Class A Common Stock which, pursuant to the Company's Certificate of Incorporation, entitles its holders to all voting rights, including the present right to vote for the election **[**47]** of the Company's board of directors.

Pursuant to the Company's Certificate of Incorporation, holders of Class B Stock have voting rights only relating to the following extraordinary corporate actions:

> a. merger or consolidation of the Company;
> b. sale, lease, exchange or other disposition of substantially all of the assets of the Company or the Partnership;
> c. increase, in any manner of the authorized number of the Company's capital stock;
> d. reclassification/recapitalization of the capital stock of the Company;
> e. amendment to the Company's Certificate of Incorporation or By-Laws; or
> f. amendment to the Company's bonus plan or enactment of any similar plan.

Similarly, holders of the Preferred Stock have voting rights only relating to the following extraordinary corporate actions:

> a. any attempt to amend, alter or repeal the Certificate of Incorporation in a way which would adversely affect the powers, preferences or rights of any share of the Preferred Stock;
>
> b. any attempt to authorize, issue, create or increase the authorized amount of any capital stock ranking senior to or on a parity with the Preferred Stock, other than as specified **[**48]** by the Agreement, or
> c. any attempt to merge with any entity or sell, lease, exchange or otherwise dispose of all or substantially all of the Company's or the Partnership's assets.

The holders of the Preferred Stock also have a contingent right to elect two directors of the Company in the event dividends payable are in arrears and unpaid for two consecutive periods or if the Company fails to discharge a mandatory redemption obligation. However, the terms of the directors elected by the holder of the Preferred Stock terminate as soon as financial defaults are cured. Clearly, the right to elect directors is intended as a financial remedy and not as a grant of control to the holder of the Preferred Stock. Further, given that the Company could opt to pay dividends in kind, rather than cash, for all dividend periods prior to September 15, 1995, no realistic opportunity to elect directors based on two consecutive missed dividends could have occurred as of the date of the confirmation hearing.

The Class B Stock and Preferred Stock held by Prudential were economic interests and were vested with limited voting rights directly related to the protection of Prudential's **[*797]** economic investment. **[**49]** These rights do not equate to control or management of the business and affairs of the Debtors. That is the province of the board of directors, and all voting power to elect directors of the Company was vested in the Class A Common Stock.

Accordingly, neither the Class B Stock nor the Preferred Stock held by Prudential would constitute "voting securities" as that term is used in the Code's definition of "affiliate." Indeed, the Securities and Exchange Commission (the "SEC") defines "voting securities" for all corporate purposes as "securities the holders of which are presently entitled to vote for the election of directors." *17 C.F.R. § 230.405 (1992)*. Congress did not redefine the term for bankruptcy purposes, and, in fact, did state in the legislative history of *Section 101(2)* that the provision defining "affiliate" is "intended to cover situations where there is an opportunity to control" a debtor. H.R. Rep. No. 595, 95th Cong., 1st Sess. 309 (1977). Courts have effectuated this expressed legislative intent in holding, consistent with the SEC definition of "voting securities," that *HN11*[] the extent of a security holder's voting power is the appropriate measure of determining whether **[**50]** one is an "affiliate" of a debtor for "insider" purposes. *In re Tyee Timbers, Inc.,* 139 Bankr. 520, 525 (Bankr. D. Or. 1992) (any preferred stock voting power arising from the state law grant of voting rights on extraordinary events such as business combinations, disposition of the debtor's property and corporate charter amendments, did not give the preferred shareholders the "opportunity to control" the debtor, and consequently, the preferred stock did not constitute "voting securities" for determining insider status); *In re UVAS Farming Corp.*, 89 Bankr. 889, 892 (Bankr. D.N.M. 1988) (determination of affiliate status was based on percentage of voting control not percentage of stock ownership). *In re Locke Mill Partners,* 178 Bankr. 697 (Bankr. M.D.N.C. 1995), a case recently decided in this district, is consistent with the foregoing authorities. The court there determined that the debtor owned more than 20% of the voting securities (albeit not evidenced by stock certificates) of the creditor who voted in favor of the plan, based upon voting rights which enabled the debtor to control the election of four of eight directors.

In *Locke Mill,* the court also considered the **[**51]** question of "control" outside the technical definition of "affiliate" and examined, as between the debtor and creditor in that case, the "relative degree of control which either has over the other." *Id at 703*. The court disqualified the vote of the creditor on the basis of "insider" status because the debtor exercised complete control over the board of directors of the creditor. *Id.* Prudential cannot be compared to the "insider" in *Locke Mill.* Prudential did not control or vote for any directors. It never attended a board meeting, even as an observer. At best, Prudential's Preferred Stock gave it a contingent right to elect two directors based on two consecutive missed dividends, a right which, as of the date of the confirmation hearing, was never a reality.

NationsBank further argued that the mandatory redemption obligations under the Preferred Stock designations became effective, thus giving Prudential the right to elect two directors, because the commencement of these chapter 11 cases resulted in the acceleration of Prudential's Notes. Such rights are not analogous to normal shareholder rights to elect directors, which are not remedies for financial defaults and which **[**52]** typically continue after bankruptcy. Needless to say, had Prudential attempted to elect two additional members to the board based on a failure to meet a mandatory redemption obligation triggered by the chapter 11 filing, NationsBank and other parties in interest would have claimed that Prudential was exercising a remedy on account of a pre-petition claim and should be subject to the automatic stay.

Even if the right to elect directors had accrued, the "control" requisite to insider status would require that such right be exercised, or at least threatened to be exercised. It is uncontroverted that Prudential never exercised or threatened to exercise such rights. In *Germain v. RFE Investment Partners IV, L.P., (In re Wescorp, Inc.),* 148 Bankr. 161 (D. Conn. 1992), the bankruptcy **[*798]** court held that *HN12*[] a creditor was not an insider even though

> . the creditor had the right to elect a majority of the debtor's board of directors upon a default under the creditors' loan agreement;
>
> . the compensation of the debtor's principals was subject to the creditor's approval; and
>
> . the creditor held warrants to purchase approximately 13% of the debtor's common stock.

Id. at 163. **[**53]**

Because "the provisions of the loan agreement which might have led to control of the debtor were *never implemented or threatened to be implemented,"* the lender was found not to be an insider. *Id.* (emphasis added). *See also, In re Technology for Energy Corp.,* 56 Bankr. 307, 316 (Bankr. E.D. Tenn. 1985) (A secured creditor of the debtor attained voting control of the debtor's stock, but because the creditor never exercised voting control, the court held that it was not an insider.)

Finally, *HN13*[] the primary objective of the exclusion of insider votes under *Section 1129(a)(1)* is to nullify the voting of a creditor who is so beholden to, or controlled by, the debtor as to be effectively an alter ego of the debtor. *In re Gilbert,* 104 Bankr. 206 (Bankr. W.D. Mo. 1989). Where there is an affinity of interests between a creditor and the debtor, that creditor is less likely to cast a vote formed on an independent judgment of what will best serve his interests, much less those of his fellow class members. *Id.* The holders of equity interests in the General Partner Debtor are not receiving any property or other rights under the Plan. Accordingly, the nature of the Plan itself and **[**54]** the fact that there is no motivation on the part of Prudential to favor any interest other than its interest as a creditor counters any contention that Prudential is an insider whose vote would not serve the purposes of *Section 1129(a)(10)*.

FEASIBILITY

The final confirmation standard to be addressed is "feasibility" under *Section 1129(a)(11)*. **HN14**[] This means that confirmation of the Plan is not likely to be followed by liquidation. Feasibility does not require that the Plan's success be guaranteed, but only that it offer reasonable assurance of success. *E.g., Kane v. Johns-Manville Corp., 843 F.2d 636 (2nd Cir. 1988)*. In assessing feasibility, the Court may consider the capital structure of the reorganized Debtors, their projected earning power, economic conditions, management's ability and likelihood of continuing to work for the reorganized Debtors, and any other factors relevant to performance of the Plan. *E.g., In re Polytherm Industries, Inc.,* 33 Bankr. 823 (W.D. Wis. 1983).

The Court finds that the Plan is feasible within the meaning of *Section 1129(a)(11)*. By distributing all of the equity in the reorganized Debtors to the Class 9 creditors and resisting NationsBank's **[**55]** proposal of adding a debt instrument, the proponents have deleveraged the business. The existing secured debt -- $ 2.1 million secured by the warehouse distribution facility -- is minimal. The exit financing facility of $ 20,000,000 is reasonable and necessary to encourage vendor support and to fulfill the business plan, including but not limited to, making investments in management systems and conversions to Home Centers. Through actual performance over the past year or so, Home Centers have proven to be profitable and are therefore a reasonable cornerstone of the Debtors' business plan. Although the Debtors have had difficulty meeting many of their past projections, recent trends are encouraging. Specifically, the evidence shows that for the first quarter of FY 1996 (which also is the first quarter of projections in the Disclosure Statement), the Debtors exceeded their projected targets for EBITDA. The projections in the Disclosure Statement are endorsed by the Debtors and by the Committee (with the exception of NationsBank). The Court finds those projections to be reasonable and supportive of feasibility.

Feasibility is enhanced by the substantial restructuring which the Debtors **[**56]** have achieved while operating in chapter 11, including but not limited to the closing of unprofitable stores, the investment in point-of sale registers, the development and implementation **[*799]** of the Home Center concept, and the assembly of an experienced management team in which most creditors repose confidence. Indeed, the fact that the Plan is proposed by the Committee as well as the Debtors increases the likelihood that it will succeed. Similarly, the fact that the creditors voted overwhelmingly to accept the Plan suggests that it is more likely to succeed than if the vote were closer.

The industry within which the Debtors operate is volatile. However, as a result of significant store closings including those by the Debtors and by House of Fabrics, another fabric/crafts retailer in chapter 11, the over-stored condition of the industry has been somewhat alleviated. Moreover, the Debtors have had some recent success in resisting the industry's deep discounting. The result for the first quarter of FY 1996 has been reduced sales (below targets) but increased margins (above targets) for the Debtors. Through the Home Center concept, the Debtors will also be able to expand into markets other **[**57]** than traditional fabrics and crafts. In sum, problems with the industry do not render the Plan infeasible

The Plan rewards management with a retention bonus and creates an incentive, through a stock option program, for management to continue working for a reasonable period of time. Moreover, the option program incentivizes management to increase the value of the New Common Stock beyond its worth at the effective date of the Plan. These provisions relating to management support feasibility.

CONCLUSION

The Plan meets all of the applicable requirements of *Section 1129*. NationsBank's objections to confirmation are overruled.

Dated: October 6, 1995.

THE HONORABLE JAMES B. WOLFE, JR.

UNITED STATES BANKRUPTCY JUDGE

End of Document

Portfolio Media. Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

DOJ Clears Co-Op's $433M Buy From Bankrupt Dean Foods

By **Matthew Perlman**

Law360 (May 1, 2020, 8:47 PM EDT) -- The U.S. Department of Justice on Friday announced a deal that will allow cooperative Dairy Farmers of America to move ahead with its $433 million purchase of assets from bankrupt milk producer Dean Foods, after the co-op agreed to shed several plants.

The DOJ said in a statement Friday that it conducted its investigation of the purchase against the backdrop of a dairy industry facing "unprecedented challenges," with the country's two largest milk producers recently hitting bankruptcy. Dean Foods **filed for Chapter 11** in November, followed by Borden Dairy Co. **in January**.

DFA won an auction in March and agreed to **purchase a majority** of Dean Foods' assets, including 44 fluid and frozen milk facilities across the U.S. Enforcers found the deal as initially proposed would end up hurting competition in three regions, but the cooperative of dairy farmers has agreed to sell plants and other equipment in each of the areas to allay the concerns, according to the DOJ statement.

Assistant Attorney General Makan Delrahim, head of the department's antitrust division, said that the dairy industry's struggles have intensified in recent weeks as the coronavirus pandemic has caused demand for milk by schools and restaurants to collapse.

"In the face of these challenges and Dean's worsening financial condition, the department conducted a fast but comprehensive investigation, and our actions today preserve competition for fluid milk processing in northeastern Illinois, Wisconsin and in New England," Delrahim said in Friday's statement.

To move ahead with the deal, DFA agreed to sell plants in Harvard, Illinois; De Pere, Wisconsin; and Franklin, Massachusetts, along with equipment and other assets. Without the sales, the deal would give DFA 70% of the fluid milk market in northeastern Illinois and Wisconsin and approximately 51% in New England, according to a complaint filed by the DOJ alongside a proposed settlement.

DFA had also considered purchasing additional Dean Foods assets in the upper Midwest, the DOJ said, but agreed to cease those efforts after the agency raised further concerns.

The complaint and settlement, filed in the U.S. District Court for the Northern District of Illinois, are joined by the attorneys general of Massachusetts and Wisconsin.

"While strong competition in the market is always important, it's incredibly important now, as we're living through a pandemic," Wisconsin Attorney General Joshua L. Kaul said in Friday's statement. "Our supply chain must have robust competition to ensure a continued supply of milk to those who need it."

Prairie Farms Dairy is also set to purchase several assets from Dean Foods after agreeing in March to purchase facilities in the South and Midwest for $75 million. The DOJ said it investigated that transaction as well, and found the plants would have been shut down absent the deal, considering "the lack of alternate operators who could timely buy the plants."

In a statement Friday, Eric Beringause, president and CEO of Dean Foods, said the clearance means the company will be able to maximize value for its stakeholders while enabling nearly all of its businesses to continue operating.

"Our team has put in considerable work over the last several months to find the right partners for our assets that would enable them to continue to succeed while preserving the most jobs possible and to ensure a smooth transition for our customers and partners," Beringause said.

Representatives for DFA and Prairie Farms Dairy did not respond to requests for comment Friday.

--Additional reporting by Jeff Montgomery, Rick Archer and McCord Pagan. Editing by Bruce Goldman.

[CS&M Draft—03/09/2021]

NYSE and NASDAQ: Bankruptcy and Delisting

The listing rules of the NYSE and the NASDAQ do not provide for the automatic delisting of companies that file for bankruptcy but that are otherwise compliant with the relevant listing standards. Instead, the exchanges exercise their discretion.

The procedures for delisting under each exchange are similar in that the processes generally include: (i) the determination that the company fails to meet the exchange's listing standards, (ii) notice to the company, alerting them to their right to review/appeal by a committee or council, (iii) the actual termination of the listing on the exchange.

NYSE: Bankruptcy and Delisting

Rule 802.01D of the NYSE Listed Company Manual provides that if an issuer files or announces an intent to file for reorganization relief under the bankruptcy laws (or an equivalent foreign law), the NYSE may exercise its discretion to continue the listing and trading of the securities of the issuer. However, if an issuer that is already below certain continued listing standards (or subsequently falls below such standards) files or announces an intent to file for relief under any provisions of any bankruptcy laws, it is subject to immediate suspension and delisting.

NYSE Rule 804.00: Procedure for Delisting

- If the Exchange staff should determine that a security be removed from the list, it will so notify the issuer in writing, describing the basis for such decision and the specific policy or criterion under which such action is to be taken. The Exchange will simultaneously (1) issue a press release disclosing the company's status and the basis for the Exchange's determination and (2) begin daily dissemination of ticker and information notices identifying the security's status, and include similar information on the Exchange's web site.

- The notice to the issuer will also inform the issuer of its right to a review of the determination by a Committee of the Board of Directors of the Exchange, provided a written request for such a review is filed with the Secretary of the Exchange within ten business days after receiving the aforementioned notice. Such written request must state with specificity the grounds on which the issuer intends to challenge the determination of the Exchange staff, must indicate whether the issuer desires to make an oral presentation to the Committee, and must be accompanied or preceded by payment of a non-refundable appeal fee in the amount of $20,000.

- If the issuer does not request a review within the specified period, the Exchange will suspend trading in the security and will file a Form 25 with the Securities and Exchange Commission to strike the security from listing and furnish a copy of such Form 25 to the issuer in accordance with Section 12 of the Securities Exchange Act of 1934 and the rules promulgated thereunder.

- If a review is requested, the review will be scheduled for the first Review Day which is at least 25 business days from the date the request for review is filed with the Secretary of the Exchange, unless the next subsequent Review Day must be selected to accommodate the Committee's schedule. The Committee's review and final decision will be based on oral argument (if any) and the written briefs and accompanying materials submitted by the parties.

- A request for review will ordinarily stay the suspension of the subject security pending the review, but the Exchange staff may immediately suspend from trading any security pending review should it determine that such immediate suspension is necessary or appropriate in the public interest, for the protection of investors, or to promote just and equitable principles of trade.

- Promptly following receipt of a request for review and the appeal fee, the Exchange's Office of the General Counsel will notify the issuer and the Exchange staff of the scheduled Review Day and the briefing schedule.

- The Committee, in its sole discretion upon written motion of either party or upon its own motion, may extend any of the time periods specified above. Document discovery and depositions will not be permitted.

- If the Committee decides that the security of the issuer should be removed from listing, the Exchange will (i) suspend trading in the security as soon as practicable, (ii) file a Form 25 with the Securities and Exchange Commission to strike the security from listing and registration and (iii) furnish a copy of such Form 25 to the issuer in accordance with Section 12 of the Securities Exchange Act of 1934 and the rules promulgated thereunder. Prior to filing the Form 25 with the Securities and Exchange Commission, the Exchange will give public notice of its final determination to remove the security from listing by issuing a press release and posting a notice on its web site. Such notice will remain posted on the Exchange's web site until the delisting is effective pursuant to Section 12 of the Securities Exchange Act of 1934 and the rules promulgated thereunder. If the Committee decides that the security should not be removed from listing, the issuer will receive from the Exchange a notice to that effect.
  Amended: May 28, 2015 (NYSE-2015-25).

NYSE Listed Company Manual: NYSE Rules (srorules.com)

<u>NASDAQ Bankruptcy and Delisting</u>

Nasdaq Rule 5110 provides that Nasdaq may use its discretionary authority under the Rule 5100 Series to suspend or terminate the listing of an issuer that has filed for protection under any provision of the federal bankruptcy laws or comparable foreign laws, or has announced that liquidation has been authorized by its board of directors and that it is committed to proceed, even though the issuer's securities otherwise meet all enumerated criteria for continued listing on Nasdaq. In the event that Nasdaq decides to continue the listing of such an issuer during a bankruptcy reorganization, the issuer is required to satisfy all requirements for initial listing, including the payment of initial listing fees, upon emerging from bankruptcy proceedings.

NASDAQ Rule 5800: Failure to Meet Listing Standards

- Securities of a Company that does not meet the listing standards set forth in the Rule 5000 Series are subject to delisting from, or denial of initial listing on The Nasdaq Stock Market. This Section sets forth procedures for the independent review, suspension, and delisting of Companies that fail to satisfy one or more standards for initial or continued listing, and thus are "deficient" with respect to the listing standards.

- The Listings Qualifications Department is responsible for identifying deficiencies that may lead to delisting or denial of a listing application; notifying the Company of the deficiency or denial; and issuing Staff Delisting Determinations and Public Reprimand Letters. Rule 5810 contains provisions regarding the Listing Qualifications Department's process for notifying Companies of different types of deficiencies and their corresponding consequences.

- The Hearings Panel, upon timely request by a Company, will review a Staff Delisting Determination, denial of a listing application, or Public Reprimand Letter at an oral or written hearing, and issue a Decision that may, among other things, grant an "exception" to Nasdaq's listing standards or affirm a delisting. Rule 5815 contains provisions relating to the hearings process.

- The Nasdaq Listing and Hearings Review Council, upon timely appeal by a Company or on its own initiative, may review the Decisions of the Hearings Panel. Rule 5820 contains provisions relating to the Listing Council appeal process.

- Finally, the Nasdaq Board of Directors may exercise discretion to call for review a Listing Council Decision. Rule 5825 contains provisions related to that process.

- Procedures related to SEC notification of Nasdaq's final Delisting Determinations are discussed in Rule 5830. Rules applicable to Adjudicators and Advisors are provided in Rule 5835 and general information relating to the adjudicatory process is provided in Rule 5840.

- A Company's failure to maintain compliance with the applicable provisions of the Rule 5000 Series will result in the termination of the listing unless an exception is granted to the Company, as described below. The termination of the Company's listing will become effective in accordance with the procedures set forth herein, including Rule 5830.

NASDAQ Rulebook: Rules - nasdaq-5800-series

https://www.wsj.com/articles/investors-mount-competing-bids-to-buy-hertz-out-of-bankruptcy-11617108075

PRO BANKRUPTCY

Investors Mount Competing Bids to Buy Hertz Out of Bankruptcy

Investors led by Centerbridge, Warburg Pincus and Dundon Capital are challenging a rival Hertz bankruptcy-exit proposal

Hertz filed for chapter 11 protection in May 2020, an early casualty of the pandemic's impact on travel.

PHOTO: DAVID ZALUBOWSKI/ASSOCIATED PRESS

By Becky Yerak and Peg Brickley
Updated March 30, 2021 12:06 pm ET

Rival groups of investors are vying for the right to back the expected recovery of Hertz Global Holdings Inc.'s car-rental business and ease a path out of bankruptcy.

One offer was already on the table when a group led by Centerbridge Partners LP, Warburg Pincus LLC and Dundon Capital Partners stepped up with a competing funding package meant to lift the rental car provider out of bankruptcy.

In court papers filed Monday, Hertz said the new offer is competitive with a proposal the company had previously floated to emerge from bankruptcy under the control of Knighthead Capital Management LLC, Certares Management LLC and other co-investors.

"This competitive process remains ongoing," Hertz said, noting that neither group has fully committed to a final deal.

An early casualty of the travel-deadening effects of the coronavirus pandemic, Hertz filed for chapter 11 protection in May 2020, its fleets idled and its future prospects uncertain. The competing offers to shepherd the company out of chapter 11 cap months of financing and deal maneuvers that kept Hertz going.

Both offers would pay off in full and in cash all senior claims, including bankruptcy financing and first- and second-lien debts, court papers said.

Hertz doesn't envision that current shareholders will receive any compensation, dashing hopes from individual investors that piled into the company last June, touting the stock online despite the bankruptcy in an episode that presaged the trading mania around GameStop Corp.

READ MORE

- NRA Leadership on Trial in High-Stakes Bankruptcy Hearings April 2, 2021
- Sex-Abuse Victims Duel With Boy Scouts for Right to Steer Bankruptcy April 2, 2021
- Hedge Funds Back Day Traders' Bet on Hertz. It's 'In the Money' April 1, 2021

Hertz said it estimated that unsecured bondholders owed $2.9 billion would recover 80 cents or 75 cents on the dollar under the Knighthead-led and Centerbridge-led restructuring plans, respectively.

"Either of these transactions would leave reorganized Hertz with a strong and sustainable balance sheet," the company said.

Any transaction selected by Hertz would require approval from the judge overseeing its bankruptcy and subjected to a creditor vote. The company has said it wants to leave bankruptcy by the end of June, eager to take advantage of favorable market conditions for debt financing by riskier borrowers.

Hertz said Centerbridge has experience in the automotive, rental and travel sectors, including serving as a plan sponsor in the chapter 11 case of auto-parts maker Garrett Motion Inc. and making investments in rental and fleet-management platforms. Vehicle-related investments made by Warburg Pincus include China Auto Rental, Santander Consumer USA, online used car dealer Uxin, and auto transaction platform Cango Inc.

Certares and Knighthead formed an investment vehicle last year to back travel and leisure businesses. During the pandemic, Knighthead has invested in Chilean airline Latam Airlines Group SA and, along with Certares, Brazilian airline Azul SA .

Certares has a controlling investment in travel-management giant American Express Global Business Travel, which signed a letter of intent with Hertz earlier this month on a potential five-year business deal, according to court papers. Under the potential deal, Hertz would be designated a preferred supplier in North America to Amex GBT, a court filing said.

Hertz said it believes that an agreement with Amex GBT, if finalized, could generate an extra 6.3 million rental-car days in 2023, boosting the company's valuation by between $680 million and $882 million.

While Hertz previously said it would exit bankruptcy as a private company, both plan-sponsor groups are now proposing that it be publicly listed after leaving chapter 11, according to court papers.

Hertz entered bankruptcy with roughly $19 billion in debt when lockdown orders and fear of contagion curbed air and ground travel for business and leisure, sending Hertz's global revenue down 70% in April 2020 compared with a year earlier. Used-car values, a pillar of the business, also declined.

To reduce costs, Hertz consolidated rental locations, negotiated with airports to defer payments and laid off roughly 11,000 U.S. employees, most of whom were previously furloughed.

Hertz's push to leave bankruptcy comes after the rental-car industry experienced a rebound at the end of last year as more travelers chose to take road trips and used-vehicle values increased due to tighter supplies.

Hertz, which also owns the Thrifty and Dollar brands, has projected that revenue will rise from nearly $6.1 billion this year to $8.6 billion in 2023 as more individuals get vaccinated against Covid-19 and travel picks back up.

Write to Becky Yerak at becky.yerak@wsj.com and Peg Brickley at peg.brickley@wsj.com

Appeared in the March 31, 2021, print edition as 'Competing Bid Emerges for Hertz.'

July 27, 2020

Acquisitions of Firms in Bankruptcy Are Subject to the Antitrust Laws

Jon Jacobs, John Kaplan, Barry Reingold

Perkins Coie

PERKINS COIE
COUNSEL TO GREAT COMPANIES

The economic damage attendant to COVID-19 has already resulted in a substantial increase in bankruptcies. Acquisitions through U.S. bankruptcy courts are not exempt from challenge by government antitrust enforcers or private parties in U.S. district courts.

The existence of separate judicial tracks reflects the differing purposes of those laws. The antitrust laws are designed to preserve competition and focus on a deal's likely impact on customers in a relevant market—including, but not limited to—the debtor's customers. The bankruptcy laws, by contrast, are designed to elicit a "highest and best offer" to maximize the return to the debtor's creditors. Where a competitor of a bankrupt firm is willing to pay more than any other buyer because the transaction will permit the competitor to raise prices, the purposes of bankruptcy and antitrust laws will conflict. Clients considering acquisitions of competitors in bankruptcy should not ignore potential antitrust exposure arising from such transactions.

The Hart-Scott-Rodino Act Provides Limited Accommodations for Bankruptcy-Related Transactions

The HSR Act requires parties to an HSR-reportable transaction to file reports with the U.S. Department of Justice (DOJ) and Federal Trade Commission (FTC), then wait 30 days before closing to provide the antitrust agencies an opportunity to review the transaction. Reportable transactions are those in which the parties satisfy a "size of transaction" test (currently $94 million) and a "size of person test." If either agency opens a formal investigation by issuing “second requests” for information, the transaction is stayed until both parties substantially comply, a process that typically takes six to nine months. If, following compliance, the reviewing agency concludes the acquisition may substantially reduce competition, it may challenge the transaction in U.S. district court. The litigation will extend the stay another four to six months.

The Bankruptcy Code amends the HSR Act by providing an expedited 15-day (rather than 30) review period for sales of a debtor's property under Bankruptcy Code Section 363 (b). The HSR filing can take place only after the bankruptcy has been initiated. The filing on behalf of the debtor (as the "acquired person" for HSR purposes) is made by the trustee (or “debtor in possession” in a typical Chapter 11 case). The buyer's filing is made by its ultimate parent entity. The 15 days do not begin to run until both the trustee and the acquiring person have filed.

The bankruptcy court’s "highest and best offer" analysis does not address substantive antitrust concerns. Yet, in deciding whether to approve the transaction, the bankruptcy court may take into account the likelihood the transaction may not be the best deal for the debtor because it may not survive antitrust review. As a practical matter, if the FTC or DOJ is likely to issue second requests, the open-ended delay and uncertainty attendant to antitrust review will almost inevitably lead the bankruptcy court to deny approval.

Bankruptcy Law's Impact on Antitrust Enforcement Decisions

The antitrust enforcement agencies have made clear that transactions driven by COVID-19-related financial distress will be analyzed no differently than transactions involving other financially distressed firms. Where the acquisition of a distressed firm by a competitor threatens substantially to lessen competition, the fact that the buyer offered appreciably more for the business than did other bidders is irrelevant.

The parties may argue that for antitrust purposes, the bankrupt firm is a "failing company" whose acquisition will not impair future competition in the relevant market. To establish status as a "failing company," the debtor must prove to the district court that, among other things, the firm made unsuccessful good faith efforts to elicit reasonable alternative offers that would have posed a less severe danger to competition. The agencies regard any offer above liquidation value as "reasonable," because such an offer signals that the buyer intends to keep the assets operating in the relevant market.

Takeaways

A client proposing to acquire a competitor in bankruptcy in an HSR-reportable deal must develop strategies to convince the seller, other financial stakeholders, and the bankruptcy court that antitrust concerns will not derail the transaction. The client should also be prepared to persuade the antitrust agencies the deal does not pose material competitive concerns, or, if such concerns exist, that they may be addressed by a divestiture of specific assets or another remedy.

Faculty

Hon. James L. Garrity is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Feb. 17, 2015. Previously, he was a partner in the law firm of Morgan Lewis & Bockius LLP and co-head of its Bankruptcy & Restructuring group, where his practice included the representation of debtors, creditors, and other parties in chapter 11 cases and out-of-court restructurings. Prior to joining Morgan Lewis & Bockius, Judge Garrity was a partner at Shearman & Sterling LLP in its Financial Restructuring & Insolvency Group, and before that he served as a U.S. Bankruptcy Judge in the Southern District of New York from July 1991 to December 1999. Prior to his first term on the bench, he served as an assistant U.S. attorney for the Southern District of New York, inlcuding serving as chief of the office's Tax & Bankruptcy Unit, and was an associate at the New York law firm of Andersen, Russell, Kill & Olick, P.C. Judge Garrity is a Fellow in the American College of Bankruptcy, a member of the American Law Institute and a member of the International Insolvency Institute. He is also an adjunct professor at St. John's University School of Law's LL.M. in Bankruptcy program. Judge Garrity received his B.A. from the College of the Holy Cross in 1977, his J.D. from St. John's University School of Law in 1980 and his LL.M. in Taxation from New York University School of Law in 1986.

Kristopher M. Hansen is a partner with Stroock & Stroock & Lavan LLP in New York and chairs its Financial Restructuring Group, which encompasses four distinct business units: restructuring, debt finance, distressed corporate and impact litigation. He has guided clients through proceedings in bankruptcy and appellate courts across the country, as well as through many out-of-court situations. Mr. Hansen helps sophisticated investors in distressed credit formulate and execute complex strategies involving mergers and acquisitions, financing and litigation in and outside of actual bankruptcy. He represents official creditors' committees in complex corporate chapter 11 cases, and corporate debtors in connection with formal bankruptcy proceedings and informal negotiations to restructure their debt obligations. Mr. Hansen is a frequent panelist and lecturer on restructuring topics before corporate, professional and CLE audiences. He is listed in *The Best Lawyers in America*, *Chambers USA* and *Chambers Global*, *IFLR1000*, *Law360* and *The Legal 500*, and he has been recommended by *Benchmark Litigation*. Mr. Hansen is admitted to practice before the courts of the State of New York, the Southern and Eastern Districts of New York, the U.S. Courts of Appeals for the Second and Third Circuits, and the U.S. Supreme Court. He frequently lectures and has published articles on the distressed marketplace. Mr. Hansen received both his B.S. in finance in 1992 and his J.D. in 1995 from Fordham University.

William H. Henrich, CPA is co-chair of Getzler Henrich & Associates LLC in New York and has more than 35 years of experience in turnaround and crisis management, loan workout, bankruptcy consulting, with over 400 engagements. He is experienced in helping debtors restructure their businesses, improve operations, boost cash flow and profitability, and maximize recovery for stakeholders. He also has expertise in advising secured and unsecured creditors during chapter 11 bankruptcy proceedings, including developing plans of reorganization and providing bankruptcy forensic analysis to support litigation. Prior to joining Getzler Henrich, Mr. Henrich was managing director of the New York practice of a prominent middle-market corporate restructuring firm. He also served in Arthur Andersen's corporate recovery services group, and in 1982 started its New York bankruptcy and restructuring practice. Mr. Henrich is a former president and current advisory board member of the Turnaround Management Association's New York chapter and frequently lectures and writes on turnaround and bankruptcy issues, and he served as co-chair of ABI's Chapter 11 Reform Commission's Governance Committee. He also sits on ABI's Board of Directors as an At-Large member of its Executive Committee. He holds a B.B.A. from Baruch College, City University of New York, and an M.B.A. from Harvard Business School.

Brett H. Miller is a partner with Willkie Farr & Gallagher LLP in New York in its Business Reorganization & Restructuring Department and is the firm's global head of Creditor Rights. His clients include official and ad hoc creditors' committees, bank groups, individual lenders, court-appointed fiduciaries, debtors, and investors that focus on distressed situations. Mr. Miller advises on chapter 11 cases, out-of-court restructurings, bankruptcy-related acquisitions, cross-border insolvency matters, bankruptcy-related litigation and insolvency-sensitive transactions. He has represented parties in restructurings in such industries as real estate, transportation, retail, manufacturing, food service, oil and gas, and media. Mr. Miller is a Fellow of the American College of Bankruptcy and is listed as a leading lawyer for Bankruptcy & Restructuring in *Chambers Global*, *Chambers USA* and *Legal 500 US*. He also has been recognized by *Law360* as an "MVP" of the bankruptcy bar, and *Turnarounds & Workouts* also named him an "Outstanding Restructuring Lawyer." Mr. Miller received his B.A. from Columbia University in 1988 and his J.D. from Georgetown University Law Center in 1991.

Steven A. Seiden is president of Seiden Krieger Associates, Inc. in New York and recruits top executives and directors for corporations in transition. Among his clients are many of America's most publicized acquisitive entrepreneurs and activists who seek out undermanaged companies needing new chief executives and board members, as well as operational, financial and marketing talent. These include conglomerates, international holding companies, merchant banks, private-equity investors and venture capitalists. Mr. Seiden profiled in the book *The Career Makers: America's Top 150 Executive Recruiters* and is named as one of an even more select group of specialists who recruit senior officers for holding companies. Additionally, he finds new management and directors for companies emerging from bankruptcy and in hostile situations. Mr. Seiden's other clients include many Fortune industrial and service companies. Before founding Seiden Associates, his predecessor firm, he spent 17 years on Wall Street helping to build and manage a successful financial services and investment banking organization. His articles have appeared in *Business Week*, *Bankruptcy Professional*, *Directors & Boards*, *The Congressional Record*, *The Wall Street Journal*, *Barron's*, *The Corporate Board*, *Business Law Today* and *Director's Monthly*. Mr. Seiden has been a panelist for the New York City Bar Association and served in the U.S. Army. He is a member of the International Association of Corporate & Professional Recruiters, the Turnaround Management Association and formerly the New York Society of Securities Analysts. Mr. Seiden received his undergraduate degree from Yale University.

Paul H. Zumbro is a partner in Cravath, Swaine & Moore LLP's Corporate Department in New York and heads the firm's Financial Restructuring & Reorganization practice. His practice focuses on restructuring transactions and related financings, both in and out of court, as well as on bankruptcy M&A transactions. Mr. Zumbro's restructuring experience includes advising the firm's corporate and financial institution clients on bankruptcy issues, and advising on debtor/creditor rights in a variety of contexts. His restructuring experience includes both debtor- and creditor-side representations, and also includes work in the fields of municipal and sovereign debt-restructuring, as well as insolvency-related litigation matters. His recent matters include representing PG&E in connection with its $5.5 billion DIP financing, its $40+ billion debt and equity exit financing and other advisory matters relating to PG&E's reorganization proceedings under chapter 11, and The Weinstein Company in connection with its voluntary chapter 11 petition. Mr. Zumbro is a member of ABI, the International Bar Association (IBA) and the IBA's Banking Law and Insolvency, Restructuring and Creditors' Rights Committees, and he was elected to serve on the Thomson Reuters *Practical Law* Bankruptcy Advisory Board. He has been named a "Bankruptcy MVP" by *Law360* and has been listed in *The Best Lawyers in America*, *The Legal 500 US* and *IFLR1000* for his skill in bankruptcy and corporate restructuring. He also has been named by *Lawdragon* as one of "500 Leading Global Restructuring & Insolvency Lawyers," "500 Leading U.S. Bankruptcy & Restructuring Lawyers" and "500 Leading Lawyers in America." Mr. Zumbro received his B.A. *cum laude* and with distinction from Yale College in 1992 and his J.D. from Columbia Law School in 1997, where he was a Stone Scholar.