

***The Next Downturn:
Managing Risks and Capitalizing on Opportunities***

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Agenda

- **Introductions**
- **Bankruptcy – A Brief Overview for the Uninitiated**
- **Vendor/Customer Bankruptcy Filings**
- **Bankruptcy Considerations for Lenders**
- **Bankruptcy Strategies/Considerations for Prospective Buyers**
- **“Hail Mary” M&A with Distressed Companies**
- **Considerations for a Company Filing**
- **Other Restructuring Processes**
- **Questions**

Bankruptcy: A Brief Overview

- **A federal process overseen by a Bankruptcy Court system**
- **Governed by the United States Bankruptcy Code and a set of federal and local rules and procedures**
- **There are two typical options for a corporate “debtor”: chapter 7 (liquidation) and chapter 11 (generally used for reorganization)**
 - In chapter 7 a “chapter 7 trustee” oversees the case to liquidate the estate/assets, takes over the debtor
 - In a chapter 11, management (or a turnaround expert(s)) will run the debtor, with the end goal to sell and/or confirm a reorganization or liquidation plan
- **Pre-negotiated, pre-pack and “free fall” cases**

Bankruptcy: Participants and Life Cycle

■ Participants:

- “Debtor-in-possession”/Trustee
- Bankruptcy Court
- United States Trustee
- Committees/Ombudsmen
- Creditors/Interest Holders (Equity)
- Examiners/Fee Examiners

■ Life Cycle (Chapter 11)

- Filing & First Day Pleadings
- DIP Financing
- Interim Sales
- 341 Meeting & Schedules
- Filing a POC
- Disclosure Statement & Voting
 - 2/3 amount, 1/2 + in number
- Plan Confirmation
- Exit

Bankruptcy: Benefits & Detriments

- **Automatic Stay**
- **Rejecting Contracts/Assuming & Assigning Contracts**
- **DIP Financing & Priming Liens**
- **Contesting Liens**
- **Discharge of Claims**
- **Favorable Forum**
- **Preference & Fraudulent Transfers (“Clawback Actions”)**
- **“Cramdown” (or “Cramup”)**

Specific Scenarios

Bankruptcy: Vendor/Customer Filings

- **Pre-filing - protecting yourself/dealing with a distressed entity**
 - **Keep your AR current! Use caution in new transactions!**
- **At filing – cease all collections/demand efforts**
- **Monitoring a bankruptcy case once filed**
- **Filing a proof of claim**
- **Reclamation claims/Enforcing consignment rights**

Bankruptcy: Vendor/Customer Filings

- **“Critical vendor” status**
- **Participating on a committee/in a bankruptcy case**
- **IP licenses - § 365(n) for non-debtor licensees; non-debtor licensors**
 - Contracting around the risk
- **Bracing for a “clawback” or avoidance action**

Bankruptcy: Avoiding Clawbacks

- **Preference Actions:** Transfer of an interest of the debtor in property, on account of an antecedent debt, to/for the benefit of creditor, made while debtor was insolvent, provides greater relief than liquidation/if transfer not made (**90-Day to 1 Year (insiders) Reach-back**)
 - **Legal defenses include:** (i) [That the transfer does not meet the preference criteria], (ii) new value, (iii) contemporaneous exchange and (iv) ordinary course (debt incurred, transfer made)
 - Best line of defense: Keep your AR current on a regular basis, and require COD/pre-payments if truly insecure, to the extent possible.

- **Fraudulent Conveyances:** Transfer/obligation incurred (i) with intent to hinder, delay or defraud, or (ii) received less than reasonably equivalent value and was insolvent/made so, was/made inadequately capitalized or incurred debts beyond ability (**2-Year Reach-back**)
 - Best line of defense: (i) Beware transactions with insolvent counterparties who cannot provide a solvency opinion, (ii) market, market, market – or otherwise prove value, (iii) beware LBOs and (iv) beware of out of ordinary insider employment payments

- **State Fraudulent Conveyances:** The Bankruptcy Code provides a way in which to incorporate state fraudulent transfer statutes, which are typically similar to that of bankruptcy actions (**Can reach back multiple years, depending on state statute**)
 - Best line of defense: Same as with bankruptcy fraudulent transfer actions.

Bankruptcy: For Lenders

- **Perfecting your security interest and claim in the lead-up to a possible bankruptcy**
 - **Be certain you are perfected (especially at closing) – don't be surprised!**

- **Preference avoidance of liens – ending up unsecured**
 - There is a 30-day grace to perfect liens, if that grace period is surpassed – then the “transfer” (or granting of a lien) may be deemed to have been made *when the lien was perfected*
 - This means that if you perfect 60 days after your closing, but within 90 days pre-petition, your liens can be avoided
 - Unperfected liens may be deemed to have been granted (i.e., “transferred”) immediately prior to the bankruptcy filing, and also avoidable as falling within the 90 days

Bankruptcy: For Lenders

- **Filing an involuntary**
 - It just takes 3 unsecured claims (or 1 with less than 12 creditors); requires generally not paying debts as they come due
 - If the petition is dismissed, costs and damages (including punitive) may be charged

- **Participating as DIP lender/seeking adequate protection**
 - Beware of priming liens – and ensure you have adequate protection (cash, replacement liens, “indubitable equivalent”)

Bankruptcy: For Prospective Buyers

■ Types of Bankruptcy Sales:

- Section 363 Sales
 - Provides for sales of assets “free and clear”
- Plan Sales
 - Can obtain releases, and similar protections
 - Can also get relief from transfer taxes if sale is done in the context of a plan

■ Benefits/Key Issues:

- Free & clear order
- Structured
- Transparent
- Auctions/multiple constituents
- Possibly lengthy process

Bankruptcy: For Prospective Buyers

▪ Sale Process:

- Bid Procedures
- Break-Up Fees
- Competing Bids
- Auction
- Hearing
- Sale Order

▪ Sale Considerations:

- Serving as “Stalking Horse”
- Diligence & Reps
- Credit Bidding (“Loan to Own”)
- Running a fulsome marketing process
 - Avoiding valuation fights
 - Avoiding evidentiary issues

“Hail Mary” M&A Deals with Distressed Companies

Structuring

- **Stock v. Asset Sales**
- **Tailoring an APA**
- **Leaving Behind Liabilities**

Risks

- **Fraudulent Conveyance Issues/Preference**
 - Subsequent Bankruptcy Risk
 - Insolvency
 - State Look-Back Statutes
- **Successor Liability**
- **Fiduciary Duties**
 - Zone of Insolvency

“Hail Mary” M&A Deals with Distressed Companies

Post-Closing Issues

- **TSA**s
- **Indemnification**
- **Subsequent Bankruptcy Risks**
 - Rejection of contracts that are negotiated post-close

Bankruptcy: Considerations for a Company Filing

- **Deciding whether filing makes sense**
- **Planning for bankruptcy**
 - Seeking counsel
 - Diligence and preparation
 - Timing and expense
- **Fiduciary considerations**
- **Do Not Start Thinking of Bankruptcy When Cash is Thin!**

Other Restructuring Processes

UCC Article 9 Foreclosures

- Can be an out of court process
- Public/private sale or “strict”
- Personal property
- Initiated by a secured lender
- Not a borrower/debtor process
 - Does not have to be consensual
- Public sale can be run like a Section 363 sale

Wind-down & Dissolution

- Governed by state statute
- Few/no protections

Other Restructuring Processes

“ABC’s” – Assignment for the Benefit of Creditors

- Can be an out of court process
- Governed by state statute – so will differ by state
- Often managed similar to a bankruptcy case, including filing of claims
- Run by an “Assignee”
- May not have automatic stay and other bankruptcy protections if out of court
- Can be an efficient way in which to purchase assets of a distressed company

Questions?