
ONE FIRM WORLDWIDE®
JONES DAY®

JONES DAY

CLE ACADEMY

11:00 a.m. - 12:00 p.m.

EMERGING OPPORTUNITIES IN DISTRESSED M&A

Caitlin Cahow, Jeffrey Ellman, Jamie Hadfield & Dan Merrett

PRESENTERS

Caitlin Cahow
Associate
Jones Day

Jeffrey Ellman
Partner
Jones Day

Jamie Hadfield
Managing Director
Configure Partners

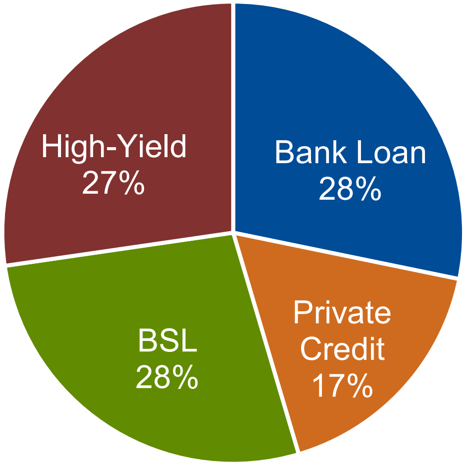
Dan Merrett
Partner
Jones Day

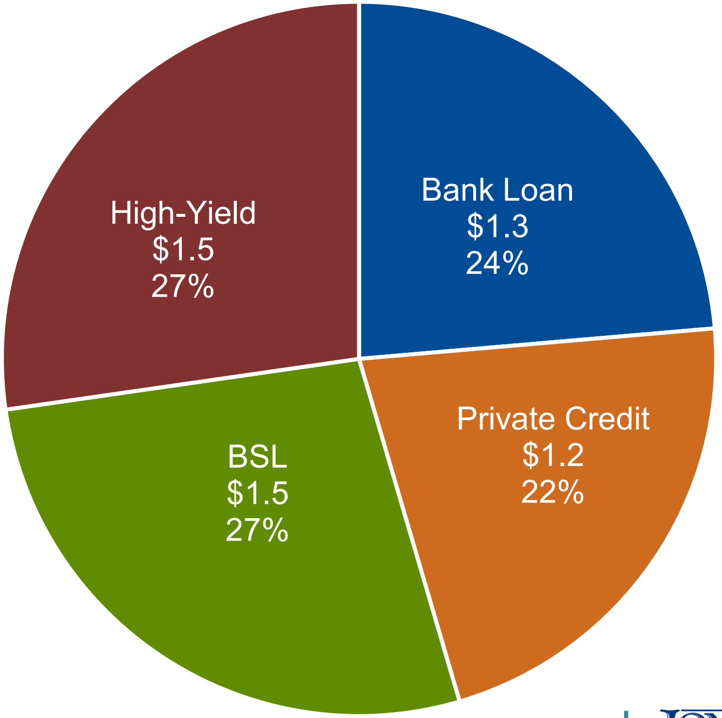
AGENDA

- Growing Corporate Distress and Opportunities
- Motivations of Stakeholders in Distressed Businesses
- Key Considerations for Acquiring Distressed Assets
- Risks of Traditional Transaction Structures
- Benefits and Limitations of § 363 Sales in Chapter 11
- Alternatives to Chapter 11

2022 U.S. DEBT MARKETS: $5.5T (EXCLUDES CORPORATE INVESTMENT GRADE BONDS; $ IN T)

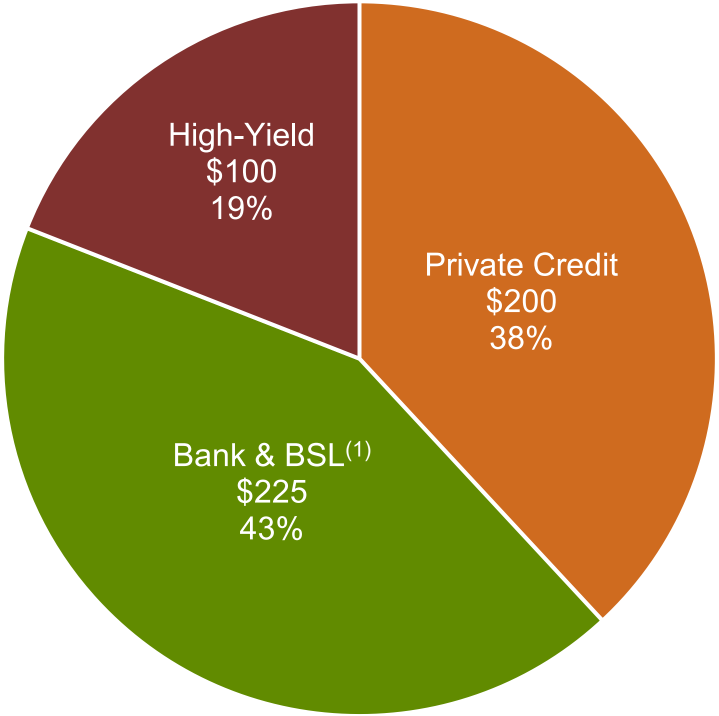
2011
Market Size: ~$1.8T





Source: Neuberger Berman, Fidelity, Preqin, SIFMA, Credit Suisse

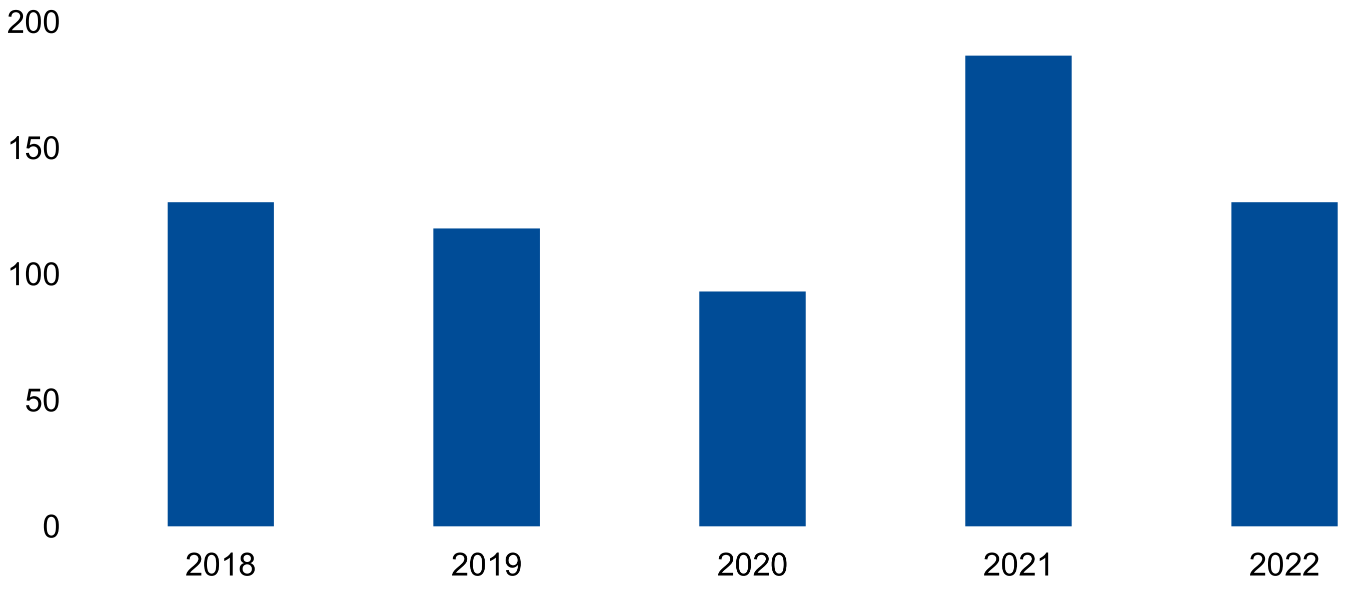
2022 U.S. ISSUANCE ($ IN B)



(1) Institutional Loans include broadly syndicated loans and bank loans

Source: SIFMA

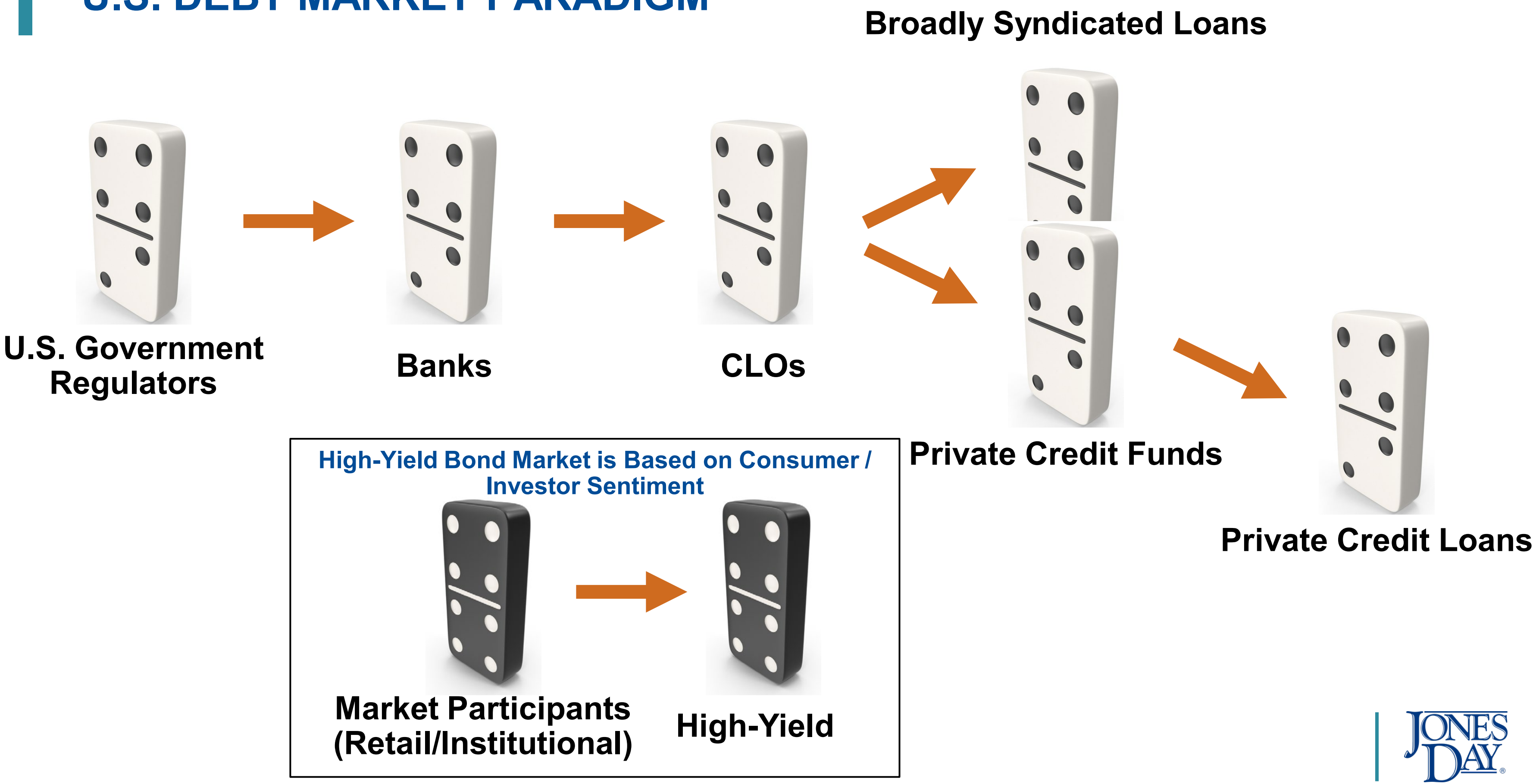
CLO FORMATION IN 2022 VS PRIOR YEARS ($ IN B)



Source: LCD / Pitchbook

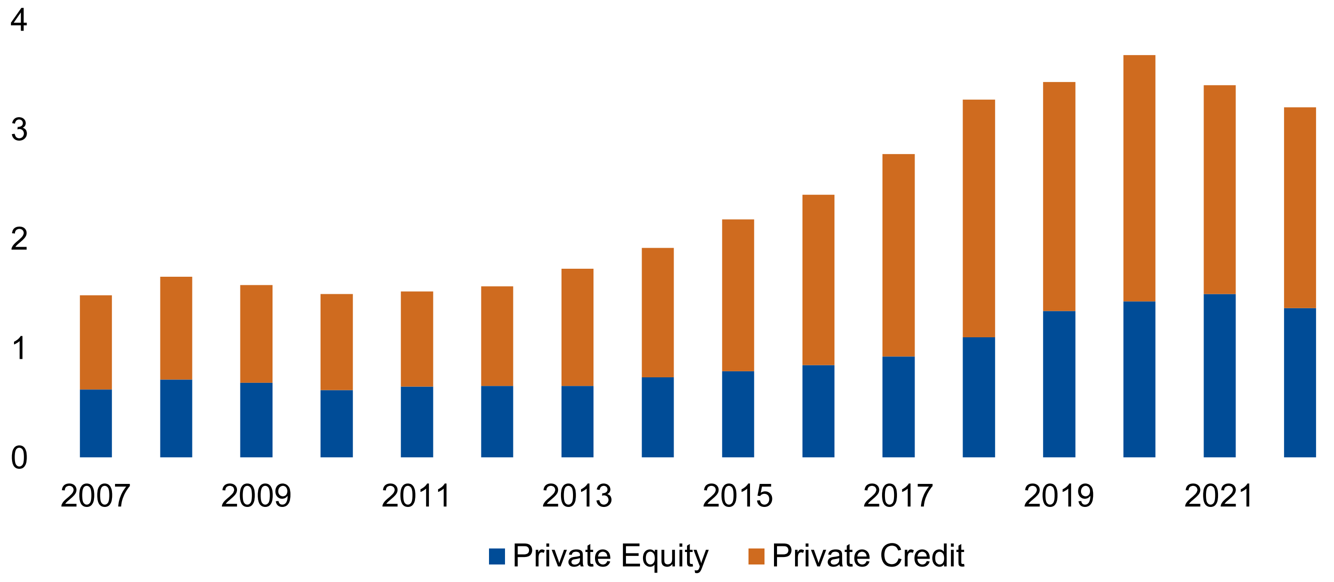
JONES DAY

U.S. DEBT MARKET PARADIGM



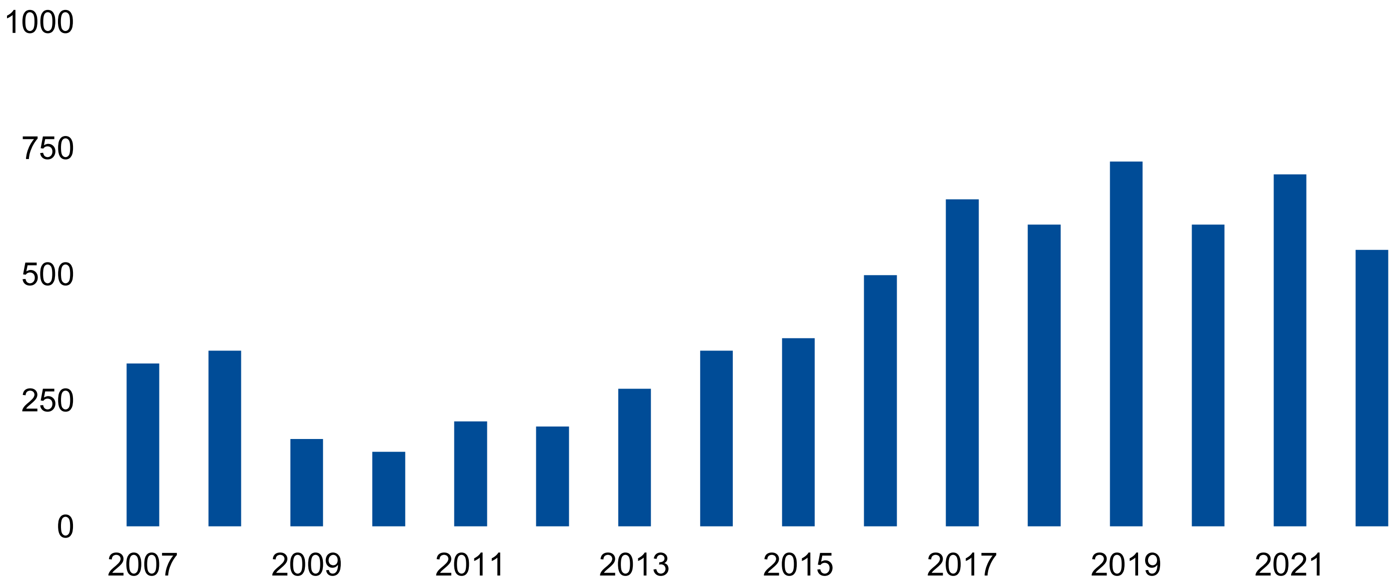
JONES DAY

PRIVATE CAPITAL DRY POWDER ($ IN T)



Source: Pitchbook

PRIVATE EQUITY FUNDRAISING ($ IN B)



Source: Preqin

KEY CONSIDERATIONS - STAKEHOLDER MOTIVATIONS

- Stakeholders driving the process for a distressed business can have dramatically different motivations and behavior:

Banks – Performing debt vs. in workout

Private credit – Par holder

Bond holders – Par vs. 80 cent buyers vs. 50 cent buyers

  – Advisor to bondholder group often calling shots; usually a larger financial advisor or investment banker

BSL holders – Par vs. 80 cent buyers vs. 50 cent buyers

  – Advisor can be calling shots, but often 1 or 2 larger hedge funds are controlling behind the scenes

KEY CONSIDERATIONS – BUSINESS RISKS

- Business Risks
  - Maintenance or capital expenditures may have been deferred by distressed seller
  - Public knowledge of distress may negatively impact market value and perception of business and assets
  - Potential that fraud has occurred
  - Some assets may carry potentially troublesome liabilities
  - Potential that books and records have not been maintained
  - Likelihood that transition services will not be available or reliable

KEY CONSIDERATIONS – TRANSACTION RISKS

- Transaction Risks
  - Ability to bind stakeholders (creditors, equity, counterparties)
  - Level of control over process
  - Amount of publicity regarding acquisition
  - Number of competing bids
  - Cost and delay of process
  - Strength of reps, warranties, indemnities, further assurances, transition services
  - Potential successor liability concerns
  - Risk transaction could be unwound

LIMITATIONS OF TRADITIONAL TRANSACTIONS

Advantages	Disadvantages
• Possibly less competitive private sale could result in a better price	• No ability to bind resistant stakeholders to process
• Publicity level easier to control	• No ability to purchase assets free and clear
• No oversight except any regulatory approvals	• No ability to take contracts without consent
• Process can be fast	• Traditional reps, warranties and indemnities of dubious value
• Parties often more familiar/comfortable with a traditional process	• Contemplated transaction may be derailed by a bankruptcy filing
	• Purchase may be unwound as a fraudulent transfer, particularly if the price was good
	• Creditor actions may disrupt sale
	• Contract counterparties may be disaffected and cannot be bound

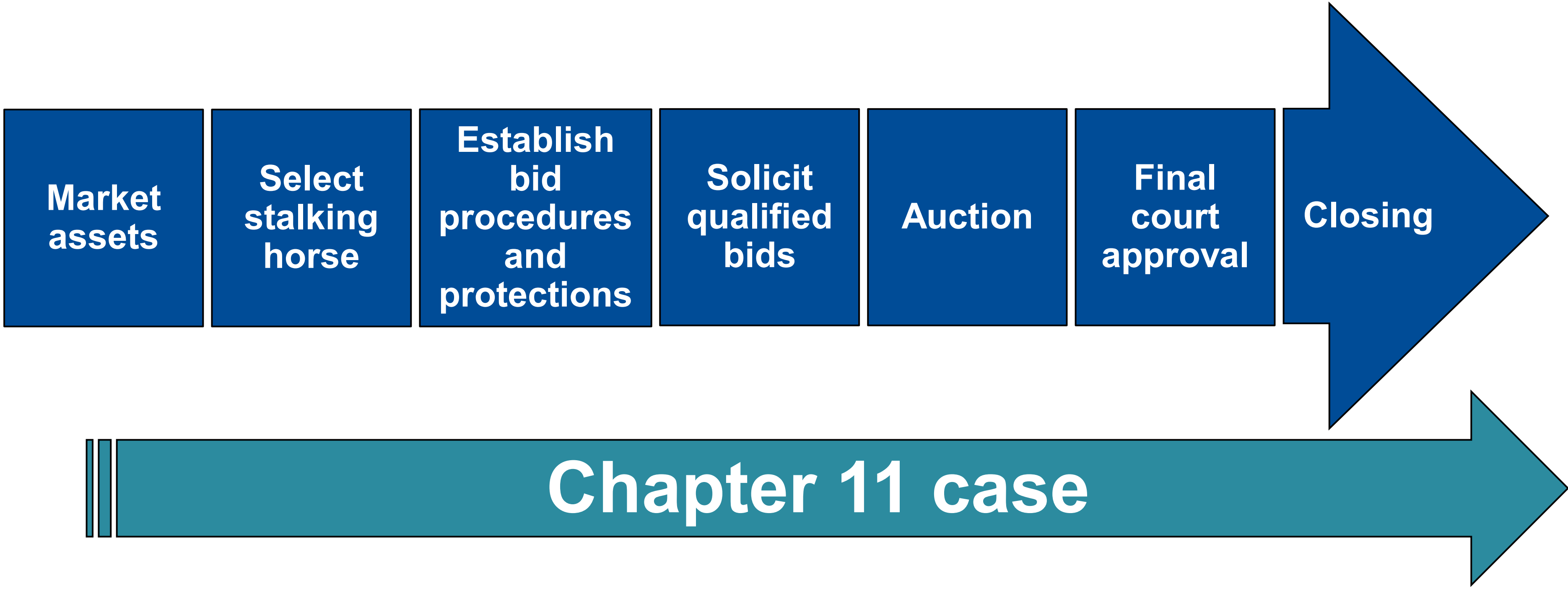
PURCHASING ASSETS IN CHAPTER 11

- Two mechanisms to effectuate a sale
  - Pursuant to a confirmed chapter 11 plan (a “plan sale”)
  - Standalone sale by motion (a “§363 sale”)
- Plan sale
  - Purchaser may acquire some or all assets, or the reorganized business
  - Requires solicitation of creditor votes through court-approved disclosure statement; ½ in number and ⅔ in amount of voting creditors in certain classes must approve
  - Purchaser may accumulate claims/votes for strategic purposes

PURCHASING ASSETS IN CHAPTER 11 (CONT'D)

- §363 sale
  - Section 363(b) allows a chapter 11 debtor to sell assets outside of the ordinary course of business "after notice and a hearing"
  - Purchaser can select from among the debtor's assets and liabilities; assets generally sold free and clear of claims, liens, and interests
  - Sale of significant assets generally involves an auction process approved by the Bankruptcy Court
  - Purchaser may serve as "stalking horse" bidder
  - Sale subject to approval of the Bankruptcy Court

THE 363 SALE PROCESS OVERLAYING A CHAPTER 11 CASE



STALKING HORSE BIDDER: TO BE OR NOT TO BE?

Potential Advantages	Potential Disadvantages
• Ability to set the opening bid and form of contract; ability to participate in establishing bidding procedures • Availability of a break-up fee and/or expense reimbursement in the event Purchaser loses the auction • Ability to eliminate potentially onerous provisions of the deal from the outset • Ability to highlight unique aspects of offer and obtain other competitive advantages	• Difficulty and expense of negotiating, potentially with multiple constituencies • Uncertainty of court approval of agreed bidding procedures • Risk of bidding too much or too soon versus a "wait-and-see" approach

FORM OF PURCHASE AGREEMENT IN §363 SALES

- **Generally the same as in a non-bankruptcy transaction, with some exceptions:**

Bankruptcy Process Provisions regarding, e.g., bid procedures order, sales order and contract assignment	**Post-Closing Obligations** Minimal obligations for transition services and fewer post-closing covenants
Credit Bidding Consideration may include credit bid of claim	**Closing Conditions** Fewer conditions to closing; "Material Adverse Change" clauses and effect of bankruptcy filing
Assignment of Contracts Specification of contracts and provisions for cure	**Governing Law** Qualified by reference to federal bankruptcy laws
Reps & Warranties Fewer – sometimes virtually none	**Jurisdiction** Submission to bankruptcy court for sale
Environmental Matters Assumption of environmental liabilities as "owner/operator"	**Corporate Authority** Court order eliminates need for certain corporate consents/formalities and other closing conditions
Indemnities No indemnification or limited escrow	**Post-Closing Disputes** Most likely determined by the Bankruptcy Court

§363 SALE BENEFITS / RISKS TO THE PURCHASER

Benefits	Risks
• "Stalking horse" opportunities	• Due diligence obstacles
• Purchaser typically takes assets "free and clear," assuming only specific, identified, liabilities	• "As is, where is" sale
• Successor liability/fraudulent transfer risk diminished	• May not eliminate future claims
• Possible to assume most contracts; opportunity to renegotiate key contracts	• Lack of exclusivity / risk of loss of sale
• "Good faith purchaser" protections	• "Back-up" bidder lock-up
• "Bridge to sale" financing opportunities	• Widespread publicity; sale subject to substantial scrutiny
• Establishes forum to resolve post-closing disputes	• Potential delays to closing
• Ability to credit bid secured debt	• Limitations on collaborating with other purchasers

STRATEGIC CONSIDERATIONS

- Purchaser should understand the motivations/goals of key players, including:
  - Debtor’s management
  - Bankruptcy DIP Lenders
  - Pre-bankruptcy secured creditors
  - Unsecured Creditors’ Committee
  - Key customers or vendors of Debtor
  - Taxing authorities/Regulators
  - Unions
- Strategic options for Purchaser may include:
  - Providing interim financing (if needed) until deal closes as way to exercise greater control over sale process
  - Engaging in claims acquisition strategy to allow “credit bidding” or plan voting control
  - Negotiating with key contract parties

NON-BANKRUPTCY ALTERNATIVES – RECEIVERSHIPS

- Receiverships involve requests that a court appoint a person to administer some or all of a debtor's assets
- Receivership requests may be made to state or federal courts so long as jurisdiction exists; state-court receiverships are far more common
- Georgia Receiverships
  - Governed generally by O.C.G.A. §§ 9-8-1 to 9-8-14
  - Appointment may be requested by a party: (a) with an affected interest that cannot otherwise be protected; or (b) in manifest danger of loss or threatened with an injury
  - A particular receiver is usually recommended by the requesting party, but the court retains discretion to appoint a different receiver

PURCHASING ASSETS FROM A RECEIVERSHIP

- The duties of a receiver are governed by the appointment order
- Receivership sales typically take the form of public auctions and are treated as a judicial sale, although private sales are sometimes possible
- The sale procedures are governed by the appointment order
- The process can be streamlined and customized over chapter 11 because of the receiver's limited role specified in the order
- Any proposed sale will be subject to court approval unless the appointment order provides the conditions for approved sales in advance
  - Just as in chapter 11, a purchaser may be bound pending court approval

FEDERAL RECEIVERSHIPS

- Although uncommon, federal receiverships may hold advantages for an asset purchaser in certain circumstances
- Federal receivership authority is generally grounded in Fed. R. Civ. P. 66 and 28 U.S.C. § 3103, *et seq*.
- Where jurisdiction exists, the federal receivership order can provide for the administration of assets across multiple states
- Federal court has the authority to impose an injunction to stop interference with assets mirroring the broad reach of bankruptcy's automatic stay
- Process also may be faster than state-law equivalents, depending on the court's docket

ADVANTAGES/DISADVANTAGES OF RECEIVERSHIPS

Advantages	Disadvantages
• Receiver is recommended by the requesting party	• There is no right of appointment; requesting party may be unsuccessful in having receiver appointed
• Generally, faster and cheaper than chapter 11, with fewer procedural obstacles	• Receivership court is likely to require a public auction rather than a private sale
• Sale is approved by court order, minimizing fraudulent transfer and successor liability risk	• Any purported free-and-clear sale in the court's order may be subject to challenge
• Receivership court may enjoin creditor actions to facilitate sale	• Contracts typically cannot be purchased without consent (and may be defaulted by the proceeding)
• Some protection against fraudulent transfer/successor liability risk	• Transaction may be derailed or unwound by a bankruptcy filing
• Reduced publicity over a chapter 11	• Process remains public record with court involvement
	• Fewer tools for a complex transaction than chapter 11; less precedent

ASSIGNMENTS FOR THE BENEFIT OF CREDITORS (ABCs)

- **What are they?**
  - ABCs are state law alternatives to chapter 7 liquidation
  - Company assigns all "claimed or owned" assets to an independent fiduciary
  - Depending on the state, they may be judicially supervised (e.g., Delaware) or non-judicial (e.g., California)
    - Georgia offers non-judicial ABCs (codified at O.C.G.A. §§ 18-2-40 to 18-2-59)
  - Terms of assignment agreement govern fiduciary's powers and responsibilities
  - Fiduciary liquidates assets, solicits creditor claims and distributes proceeds
  - Notably, fiduciary is selected by company, potentially in consultation with other stakeholders
  - Where time permits, sale transaction may be hard-wired before the assignment occurs

ADVANTAGES/DISADVANTAGES OF ABCs

Advantages	Disadvantages
• Fiduciary is selected by the stakeholders	• Assets are not acquired free and clear
• Generally, faster and cheaper than chapter 11	• Contracts typically cannot be purchased without consent (and may be defaulted by the ABC)
• No court involvement (ideally)	• “As is, where is” sale; purchaser has no meaningful recourse against fiduciary or company

• Reduced publicity
    • Recording in property records;
    • Press release after the fact
	• Transaction may be derailed or unwound by a bankruptcy filing; no stay pending closing

• Some protection against fraudulent transfer/successor liability risk	• Typically requires shareholder vote to initiate
	• Less effective for a multi-jurisdiction transaction or any more complex transaction

CONTACTS

Caitlin Cahow
Associate
Jones Day – Atlanta
(404) 581-8618
ccahow@jonesday.com

Jeffrey Ellman
Partner
Jones Day – Atlanta
(404) 581-8309
jbellman@jonesday.com

Jamie Hadfield
Managing Director
Configure Partners
(678) 723-4575 Ext. 102
jhadfield@configurepartners.com

Dan Merrett
Partner
Jones Day – Atlanta
(404) 581-8476
dmerrett@jonesday.com

JONES DAY®

One Firm Worldwide®