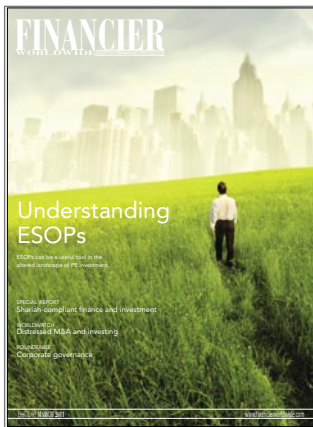


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UNITED STATES

Options for selling distressed assets

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Notwithstanding signs of capital market improvements, access to debt financing remains limited for distressed companies, many of which face impending maturities on existing debt and other burdensome obligations and challenges. Consequently, challenged companies are increasingly selling assets to buy time, fund investment in core elements of their business, de-leverage, minimise operating and capital expenditures, raise capital and fulfil fiduciary duties. On the buy-side, the popularity of asset sales is being driven by opportunistic investors, strategic and financial, enticed by relatively low valuations and an abundance of under-deployed and inexpensive capital.

While Section 363 of the Bankruptcy Code has received much attention as a favoured means of acquiring distressed assets, other transaction structures are also popular. Debtors, creditors and prospective buyers should carefully consider the benefits and risks attendant to each sale method before structuring an acquisition of distressed assets.

Asset sale vehicles

'Asset sales' broadly include everything from simple dispositions of real property or equipment to structured sales of multinational business units or substantially all of a company's assets. Among the several vehicles available for distressed asset sales are: (i) sales outside bankruptcy or other judicial proceedings, including secured party sales under Article 9 of the Uniform Commercial Code; (ii) Section 363 sales; (iii) receivership sales; and (iv) assignments for the benefit of creditors. These asset sale methods, and their benefits and risks, are briefly summarised below.

Out of court sales and secured party sales

Like healthy entities, distressed companies can choose to sell assets to willing buyers without any court process. However, it is generally inadvisable for companies near or inside the so-called 'zone of insolvency' to conduct major transactions without the protections of judicial approval or oversight, or a statutory scheme.

Directors, officers and managers of insolvent companies owe specific fiduciary duties to creditors to maximise the value of their businesses and assets. Out of court asset sales potentially expose a distressed seller and its buyer (and their respective principals) to substantial

risks, including: (i) breach of fiduciary duty claims against the seller's officers, directors and managers; (ii) actual or constructive fraudulent transfer claims against the seller, buyer, seller's shareholders or buyer's lenders; (iii) successor liability claims against the buyer; and (iv) risk of part or all of the transaction being 'unwound' at a later date. Historically, some parties preferred out of court sales for quickly and inexpensively effecting simple sales of distressed assets. However, these benefits are reduced when parties require fairness opinions and other protective measures, which are becoming more common in distressed situations, adding to the popularity of Section 363 sales.

Parties holding valid Article 9 security interests may also initiate out of court transactions, selling a debtor's interest in collateral following the debtor's default, after giving notice and observing other procedural formalities. Assets sold in an Article 9 sale transfer to the buyer 'free and clear' of any interests of the secured party and stakeholders junior to the secured party. Because no judicial process is involved and because lienholders, not debtors, conduct these sales, they are among the quickest and least expensive distressed asset sales, making their attractiveness to lenders evident. The lack of judicial involvement can invite disputes with other creditors, however, and a Section 363 sale order provides greater buyer protections than a secured party sale's simple lien release.

Bankruptcy sales

A Section 363 sale can tangibly maximise asset values, providing a true market test and other well documented benefits, including a clearly defined and transparent process, nearly every aspect of which is subject to stakeholder scrutiny and judicial oversight and approval. Additionally, because the assets transfer 'free and clear' of any 'interests' not specifically assumed, Section 363 sales are attractive to buyers seeking protection against successor liability claims and fraudulent transfer avoidance.

Several prominent examples, including in the bankruptcies of Chrysler, GM and Lehman Brothers, have recently demonstrated that large debtors can sell substantially all of their assets, and on very accelerated timelines, using Section 363. Section 363 sales are also being used in a variety of new circumstances. For example, AmericanWest Bancorporation, a bank

holding company, recently sold the stock and certain specified assets of its bank subsidiary, AmericanWest Bank, pursuant to Section 363 before the bank failed and was resolved by the FDIC pursuant to more traditional resolution methods. This transaction has triggered a wave of discussion regarding the use of Section 363 to effect sales and prevent bank failures that might otherwise be inevitable.

For many debtors wanting or needing to sell assets, the costs of a Chapter 11 case may appear to outweigh the Section 363 benefits. But many buyers demand that Section 363 be used to structure sales of distressed assets, sometimes leaving sellers little choice.

Receivership sales

Receivership is a state law proceeding in which a creditor requests court appointment of a receiver, pending some specific legal action against the debtor. Until the action is resolved, the receiver is tasked with preserving value of the property or business in question, including, in some cases, by selling the property. Because receiverships occur under court authority without the consent of the debtor, they can add legitimacy to distressed asset sales, alleviating many creditor concerns.

Most mortgage foreclosures are conducted through receiverships. In these situations, it is important to minimise the risk of damage to the assets, pending resolution of the action, by vesting control of the assets in a third party.

Receivership is not voluntarily chosen by many debtors, who lose control over the assets. Some buyers also disfavour this method, preferring instead the protections offered by bankruptcy sales.

Assignments for the benefit of creditors ('ABC')

An ABC is a state law proceeding similar to Chapter 7 bankruptcy liquidation. In an ABC, a debtor's property is consolidated and assigned voluntarily to an assignee who, like a trustee, is tasked with maximising the value of the assets through liquidation and paying creditors using proceeds, returning excess proceeds, if any, to the debtor. Some debtors prefer an ABC to Chapter 7 because it can be less complex and expensive. ABCs generally are more attractive for businesses with simple capital structures.

Unlike Chapter 7, the ABC process can vary ►►

considerably depending on location, and therefore can be confusing for some parties. For example, an ABC is a judicial proceeding in some states and entirely extra-judicial elsewhere. Also, an ABC does not discharge unpaid debts like Chapter 7 and cannot be used to sell less than all of a debtor's assets. An ABC represents an appropriate Chapter 7 alternative only in specific situations.

Conclusion

Distressed asset sales are increasingly popular for facilitating financial restructurings. Selecting an appropriate sale method depends on a number of competing considerations, including: (i) the particular assets involved; (ii) the speed of consummating the transaction; (iii) the financial cost of the process; (iv) the ability or need to sell assets free and clear of liens;

(v) the buyer protections afforded; (vi) the exposure to subsequent challenges and liability (i.e., fraudulent conveyance or successor liability claims); and (vii) which process will most likely maximise asset values for stakeholders. Choosing the most effective method for executing a sale or purchase of distressed assets is highly fact-specific and requires careful analysis and understanding of alternatives. ■



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