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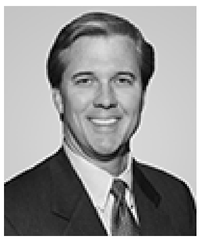
363 Asset Sales: Procedures to Facilitate a Smooth Process



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The key to any successful Bankruptcy Code Section 363 sale is a robust and vigorous auction process. How do the debtor and its estate professionals accomplish this goal? One of the primary ways is to have thoughtful and thorough bid procedures with both flexibility and certainty. The procedures should be flexible so the estate can seek broad auction participation in order to maximize value for all creditors. On the other hand, the procedures should also provide certainty in order to give bidders confidence in the auction process and encourage bidding in order to maximize value for the estate. This article will discuss the key elements which should be included in court approved bid procedures.

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Stalking Horse/ Baseline APA – Ideally in any asset sale, the estate and its constituents have a strong baseline bid for the assets to be sold, known as the stalking horse bid. The stalking horse asset purchase agreement (the "APA") often provides the foundation for the bid procedures and timing as the stalking horse will usually require both break-up fee protections and process timing requirements in its APA. A few benefits to being a stalking horse bidder are (i) access to management early in the process and the ability to perform due diligence, (ii) competing bidders must use the stalking horse form APA as its base document, and (iii) the ability to influence the timeline for the auction and sale process. In the event the debtor does not have a stalking horse bidder, the bid procedures should include a baseline form APA for all bidders to use which will assist the debtor in the comparison and valuation of various bids.

Bid Protections – The stalking horse bidder typically negotiates bid protections in case it is not the successful bidder at the auction. Different jurisdictions have different preferences towards a break-up fee and/or expense reimbursement. Some judges authorize a straight break-up fee (usually 3 percent), while some require that the stalking horse bidder come in and prove the actual costs and expenses spent on the transaction.

Sale Consideration – While it is more straightforward for the bid procedures to require that all bids be cash only, it is not uncommon for competing bidders to submit forms of consideration other than cash. Comparing cash to non-cash consideration can be difficult and requires management and the company's financial advisors to develop a matrix prior to the auction in order to determine the highest and best bid. The ultimate determination of the value of the consideration, however, is decided by the bankruptcy court at the hearing to approve the sale. Comparing cash to non-cash bids can be complex and lead to disputes. Therefore, such situations require case by case evaluation.

Minimum Overbid and Bid Increments – The bid procedures need to include the required minimum bid of any bidders other than the stalking horse. This number should be the purchase price of the stalking horse bid plus the break-up fee/expense reimbursement plus an additional overbid amount (which is determined by the debtor and its advisors). The procedures also need to include minimum bid increments which will be used in the auction.

Timing – An adequate process timeline is one of the most important ways to maximize value to the estate. Market vetting by the financial advisors can play an instrumental role here, as will the bidding and auction timing. When practicable, the debtor and its advisors should provide adequate time for prospective bidders to conduct due diligence and submit a bid. A longer sale process can often be better. However, two overriding factors on process timing are (i) the amount of cash and burn rate of the estate and (ii) any deadlines negotiated by the stalking horse bidder. Unless specific dates are included in the APA, the best method to determine the timeline is to work backwards from the desired closing date.

Bidder Participation - The steps for bidders to participate in any auction should be included in the bid procedures and include the following:

- *Confidentiality Agreement* – All potential bidders need to enter into a confidentiality agreement. It is important to timely negotiate and complete the confidentiality agreement so due diligence can begin.

- *Due Diligence* – Often the financial condition of the debtor or the condition of its books and records is such that there is not much data to review. However, to the extent that there is material information, a sufficient time period for a thorough review is needed to attract additional competitive bidders. Normally, and subject to the debtor's financial condition and cash burn, the debtor and its constituents prefer a longer due diligence process while the stalking horse bidder will generally seek a shorter time period. Ultimately, the amount of time for due diligence will depend on the date of the auction and sale hearing with diligence being completed prior to the auction and the making of a competing bid.

- *Bid Deadline* – Bids should be submitted on a specific date prior to the scheduled auction. The date needs to be early enough for management and company advisors to have sufficient time to review and analyze the bids prior to the beginning of the auction. The more complex the sale, the more time that may be needed. Typically, the bid deadline is 2 to 5 business days before the auction.

- *Bid Requirements* – All bid procedures should include the following requirements for a bid to be considered a qualified bid:
  - o *Written bids*. Bids must be in writing and submitted by the bid deadline.
  - o *Comparison to stalking horse/baseline APA*. All bids must use the stalking horse/baseline APA provided and include a redline comparison to the APA.
  - o *Cash deposit in US dollars*. Typically a cash deposit with a negotiated percentage of the purchase price is required. In today's global economy, it is also useful to require that any deposit, as well as the full purchase price, be paid solely in U.S. dollars to U.S. accounts. The bid procedures should also contain terms for deposit returns to non-winning bidders.
  - o *Bids must remain irrevocable for a set time period*. All bids should remain irrevocable until a date certain and deposits held until such date. Non-winning bidders will often be subject to back-up bidder provisions and requirements. Final bids at an auction will remain open for a negotiated time period after the contemplated closing of the transaction with 2 to 5 business days being normal.
  - o *No contingencies*. Bids may not be subject to any contingencies, including but not limited to (i) financing, (ii) board of director or other internal approval, (iii) inspection of the assets or (iv) due diligence.
  - o *Financial ability to close*. All bids should include written evidence satisfactory to the debtor that the bidder has the necessary financial ability to close the contemplated transaction.
  - o *Consent to jurisdiction* – The bid should include a statement by the bidder that it consents to the bankruptcy court's jurisdiction.
  - o *Disclosure of bidders* – Each bidder must fully disclose the identity of each entity that is participating in the bid, including if the bid is a joint or collaborative bid.

Determination of Qualified Bids and Baseline Bid – After timely bids are submitted, the debtor must determine whether the bids received are qualified bids which will allow the bidders to participate in the auction. In addition, after valuation of each bid, the debtor will determine and advise all bidders of the highest and best bid which will be the initial baseline bid presented at the auction.

Auction – The auction should be held as close to the sale hearing as circumstances permit. This provides the debtor and the winning bidder with prompt access to the bankruptcy court for approval and finality after bidding closes. Until the bankruptcy court approves the successful bid and enters the order approving same, the highest bidder at the auction may be subject to an ''upset bid'' from another party at the hearing. While some courts have refused such an upset bid after the close of the auction, because the number one goal of the process is to maximize value, other courts have allowed additional bidding at the sale hearing. A prompt hearing after the auction is a favored means to manage this risk. Auctions are often held at the offices of the company's bankruptcy counsel utilizing multiple ''side rooms'' and a general larger room for open environment bidding. In some cases, the auction may be held in the courtroom in front of the Judge. Because the bidding is not typically fast paced and because the bankruptcy courts tend to have busy dockets, an auction in the court room is the exception. At the conclusion of the auction, the debtor announces the highest and best bid on the record and declares such bidder the successful bidder. The next highest bid will be deemed the back-up bid.

Miscellaneous – The bid procedures should also include the following:

- Consultation rights for either the secured creditor or creditor's committee regarding, *inter alia*, (i) whether bids are qualified bids, (ii) the baseline bid, (iii) whether the bidder has the financial capability to perform all obligations under the APA, (iv) any modifications to the auction rules, and (v) the successful bidder.

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- Procedures for the assumption/assignment of desired unexpired leases and executory contracts.
- Provisions providing that (i) all bidders must appear in person through a duly authorized representative, (ii) the auction will be conducted in an open manner and be transcribed by a court reporter, (iii) a secured creditor may credit bid, if applicable, (iv) no other bidder is entitled to any break-up fee or expense reimbursement, (v) submission of a bid acts as conclusive evidence that such bidder has fully reviewed the bid procedures and agrees to be bound by their terms, (vi) all bidders must confirm that such bidder has not engaged in any collusion in connection with the auction or the sale, (vii) current and former employees and agents turn over any and all documents; (viii) the debtor may alter the rules of the auction in any way which will better promote the goals of the bid procedures and are in the best interests of the estate as long as such changes do not conflict with any stalking horse asset purchase agreement and (ix) the debtor has the ability to pull any and all assets from the auction if desired.

Sale Hearing – The sale hearing to approve the winner of the auction should be held as promptly after the auction concludes as circumstances permit in order to promote finality and process fairness. The sale transaction should close as soon as practicable after the sale hearing. Often, the 14 day stay for asset sales and assumption/assignment of executory contracts will be waived in the sale order, thus facilitating a prompt closing.