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# 2025 Winter Leadership Conference

## **Using LMEs in Asset Sales**

*Hosted by the Business Reorganization  
and Asset Sales Committees*

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# Liability Management Exercises and Asset Sales: When Should These Worlds Collide?



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## Panelists

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- Thomas S. Kessler, *Partner*, Cleary Gottlieb Steen & Hamilton LLP
- Matthew P. Sorenson, *Senior Managing Director*, Development Specialists, Inc.
- Rachel Jaffe Mauceri, *Partner*, Robinson & Cole LLP, Moderator



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### Today's Discussion

- Not an obvious pairing: LMEs are generally used to avoid a business failure and a sale
  - There may be times that an LME is an appropriate precursor to a sale
  - Other times, they are the ultimate result, and there are lessons to take from that as well
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### Today's Discussion

- LMEs: Brief Background
  - Asset Sales: When and why in the LME context?
  - LME to 363: Chapter 11 Cases Where a Sale Followed an LME
  - Sales Outside of Bankruptcy: Chapter 11 Alternatives
  - Case Study: Lessons Learned
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# Liability Management Exercises

Brief Background



## LMEs: What and why?

- Out-of-court debt restructurings designed to avoid bankruptcy
  - Amend existing debt terms to extend maturity
  - Raise additional cash
  - Reduce debt service
  - Can act as a bridge (turnaround, sale, another exit)



## LMEs: Typical Structures

- Uptier (Serta, Boardriders, Wesco Aircraft/Incora)
    - Involves the borrower incurring debt in a new senior tranche that primes existing debt
    - Borrower solicits consent from majority or supermajority of existing lenders to amend debt documents in order to subordinate liens on existing debt
    - Borrower then issues new debt, with participating lenders taking a senior position
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## LMEs: Typical Structures

- Drop Down (J. Crew, Revlon)
    - Borrowers move assets to an unrestricted or nonguarantor restricted subsidiary, resulting in those assets being removed from the existing collateral package
    - Those assets are then used to support new senior debt that effectively primes existing debt (at least with respect to relevant assets)
    - Borrower can leverage existing baskets to fundraise without obtaining creditor consents
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## LMEs: Typical Structures

- Double-Dips (At Home Group, Trinseo, WheelPros)
  - Existing borrower forms a new sub, lender makes a new loan to the new sub, and initial borrower guarantees the debt of the sub
  - New borrower then uses the loan proceeds to make an intercompany loan to parent existing borrower, with the loan receivable serving as collateral
  
- Results in two lender claims
  - Guarantee claim on the loan
  - Intercompany loan receivable claim



## LMEs: Why so controversial?

- Participating lenders obtain advantages such as superior collateral position or additional liens over previously unencumbered assets
  - Prejudicial to non-participating lenders, who may not have been invited to the party
- Non-participant litigants argue a variety of causes of action
  - “sacred rights” and other contractual claims
  - statutory/common law claims such as recharacterization, fraudulent transfer, breaches of fiduciary duties
- Litigation has resulted in the introduction of blocker language in some transaction documentation
  - Developing in real time and transaction-specific
  - Adoption is far from uniform



# LMEs: Facilitating Asset Sales



## How Can LMEs Facilitate Asset Sales?

- LME as bridge to fund a sale or refinance of the debt
  - Can use LME as runway to sell or a portion of a company's assets
    - May be useful to sell off particular divisions of a whole
  - Can build in milestones that set hard dates for asset sales, similar to DIP loans in the Chapter 11 context
  - Similarly, can be used to float the Company pending finding take out financing



## Risks to Utilitizing LMEs

- Company's condition worsens prior to effectuating a sale transaction (requiring additional capital or another pivot)
  - We've seen this innumerable times now in all of the cases listed above, and so many more
- LME transaction can itself spawn lender liability litigation, either in a bankruptcy or in state court litigation



## LME to 363:

LME-Related Chapter 11 Cases Resulting in an Asset Sale



## Recent Bankruptcies

- In re Robertshaw (the LME-to-363 Base Case)
  - Robertshaw conducted prepetition LMEs resulting in a “First-Out” Secured Group (and two sets of disgruntled, non-participating parties).
  - Robertshaw then filed for Chapter 11, with the First-Out Secured Group and equity sponsor serving as stalking horse bidders.
  - Litigation over non-participating lenders’ ability to credit-bid ensued, Bankruptcy Court sided with Stalking Horse Bidders and Debtors.
- In re Weiss Multi-Strategy (Disputed Liens in 363 Context)
  - Debtors sought to sell certain bonds it held, some of which were the subject to a first lien by Jefferies
  - The Debtors pursued a private sale of the bonds, and Jefferies objected, claiming a right to credit bid
  - The Court overruled Jefferies’ objection, finding that the Debtors’ existing challenge to the validity of Jefferies’ liens as preferential and constructively fraudulent justified eliminating their right to bid



## Sales Outside of Bankruptcy

Alternatives to Chapter 11



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### State law provides alternatives when bankruptcy is not an option

- Bankruptcy may not be available
  - Cost/expense
  - Time
  - Limitations imposed by federal law
- Available alternatives
  - UCC Article 9 Foreclosure/Sale
  - Assignment for the Benefit of Creditors (“ABC”)
  - Receivership



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### Risks resulting from sales under state law

- Successor liability claims
- Avoidable/Fraudulent transfer liability (UVTA/UFTA)
  - Some state ABC laws include a preference statute similar to section 547(b) of the Bankruptcy Code, for which defenses may also be available
- Director and Officer Claims



## Risks Under State Law: Successor Liability

- With a few exceptions, 363 orders generally provide finality with respect to any successor liability risk
- In general, a purchaser that acquires another's assets under state law also is not liable for the seller's debts – but there are exceptions:
  - Purchaser expressly or impliedly agrees to assume debts (courts look at intent)
  - Consolidation or de facto merger
  - Mere continuation of seller (identity of interests)
  - Fraudulent sale to escape liability



## Successor Liability: Consolidation or De Facto Merger

- Courts will consider whether there is:
  - a continuity of enterprise,
  - a continuity of shareholders,
  - a cessation of seller's ordinary business operations, and
  - an assumption of obligations
- To minimize risk:
  - reduce and/or alter form of ownership as much as possible
  - change business names, logos, management teams, and/or personnel
  - seller should continue to exist for as long as possible and be adequately capitalized



## Avoidable Transfer: Fraudulent Transfer

- Actual Fraud
  - Creditor must show the intent of the transaction was to “hinder, delay, or defraud” through various factors known as “badges of fraud”
- Constructive Fraud
  - Creditor must show that (1) the seller did not receive reasonably equivalent value for the transfer and (2) either the seller’s remaining assets were unreasonably small, the transfer rendered the seller insolvent, or the seller believed that incurring debts were beyond its ability to pay them as they became due
  - Third-party market valuation instrumental in reducing risk of fraudulent transfer



## Breaches of Fiduciary Duties

- State laws may impose fiduciary duties on a business entity’s directors and officers owed to creditors when the corporation is insolvent
- These duties generally requires Ds&Os to act in good faith and in the best interests of the business entity and its stakeholders, including creditors, and not to act in their own self-interest at the expense of the business entity
- Third-party valuations, fairness opinions, and/or independent managers/directors may help reduce risk



# Case Study: CannabisCo



## CannabisCo

- Business Operations
  - Cannabis multistate operator (“MSO”)
  - Seed-to-sale cannabis grower and retailer
- Due to nature of business, chapter 11 remains unavailable
  - Unattractive anyway due to cost
  - Lenders do not want to own company



## CannabisCo: Pre-LME Debt Structure

- Senior secured private placement notes
  - Secured by substantially all of CannabisCo's assets, including real estate
  - Held by a number of different parties
- Secured convertible notes
- Unsecured notes
- Lease obligations



## CannabisCo: Possible LME Options

- Possible LME transactions
  - Drop down: CannabisCo creates a new subsidiary, transfer real estate to subsidiary; issue new senior debt secured by subsidiary
  - Uptier: CannabisCo solicits consent from majority or supermajority of existing lenders to amend debt documents in order to subordinate liens on existing debt, then issues new debt, with participating lenders taking a senior position
  - Double-Dip
- Potential Issues/Risks
  - Documents are too tightly drafted
  - Even if permitted, LME will not raise sufficient cash
  - May get tied up in litigation



## CannabisCo: OldCo/NewCo Transaction

- If LME is not an attractive alternative, CannabisCo can use state court remedies to sell assets and wind up company
  - UCC Article 9 strict foreclosure sale/via credit bid
    - Ad Hoc Committee of Senior Noteholders form “NewCo” as acquisition vehicle
    - Asset purchase agreement between CannabisCo (or “OldCo”) and NewCo
    - OldCo’s remaining assets liquidated through state law receivership proceeding or ABC
  - Holders of Secured Notes Claims to receive pro rata share of a certain percentage of equity interests in NewCo
  - Additional NewCo equity interests to be issued in rights offering to Holders of Secured Notes Claims and Supporting Preferred Interest Holders
  - Supporting Preferred Interest Holders to receive certain percentage share of equity interests in NewCo



## CannabisCo: ABC vs Receivership

- Advantages of an ABC:
  - OldCo would have the ability to work with counsel to select the Assignee
  - Primarily out of court proceeding
  - Limitations on creditors’ ability to attach property assigned through an ABC
- Advantages of a receivership:
  - Many of the same benefits as an ABC *plus* automatic injunction
- Receiver must satisfy certain cannabis-related regulatory requirements



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### Q&A

- Questions?
- Thank you!

# Faculty

**Mark B. Joachim** is co-leader of Polsinelli’s Special Situations Investing Team in Washington, D.C., and has more than 30 years of experience representing distressed businesses, boards of directors, special committees, independent directors, debtor-in-possession lenders, distressed-debt investors, official committees, ad hoc groups of creditors in connection with special situations, corporate restructurings, liquidity and liability management transactions, recapitalizations, and in- and out-of-court restructurings. He is frequently called upon to advise boards of directors, board committees and senior management of financially troubled companies on a range of issues, including corporate governance and fiduciary duties. In addition to his work in the corporate restructuring arena, Mr. Joachim also represents equity sponsors and borrowers, as well as first- and second-lien lenders, in senior debt, mezzanine and private-equity financing arrangements. His experience and capabilities on the “new money” side of his practice allows him to formulate and implement novel and creative structures and strategies in the context of financially troubled situations. Mr. Joachim received his B.A. in 1989 in political science and philosophy from Stony Brook University and his J.D. in 1992 with distinction from Hofstra University School of Law, where he is managing editor of the *Hofstra Law Review*.

**Thomas S. Kessler** is a partner with Cleary Gottlieb Steen & Hamilton in its New York office, where he represents debtors, creditors and other parties-in-interest in a broad range of restructuring matters, including bankruptcy proceedings, out-of-court restructurings and bankruptcy-related transactions. He advises clients in high-profile restructuring matters, and he has worked with debtors and creditors to navigate complex, multi-billion dollar distressed situations and regularly litigates high-stakes contested matters, adversary proceedings and other complex civil cases. Mr. Kessler’s practice spans a variety of industries and geographies, with a particular focus on cross-border matters, including acting as U.S. counsel in foreign restructurings and lead counsel in chapter 15 proceedings. His work on the LATAM Airlines and Garuda Indonesia restructurings has been recognized by the Turnaround Management Association, which awarded both matters 2023 “Transaction of the Year” in their respective categories. Mr. Kessler was honored in 2024 as one of ABI’s “40 Under 40,” and he was awarded the 2022 Community Excellence Award from the LGBT Bar Association of Greater New York. He received his B.A. *magna cum laude* in 2010 from the University of Akron and his J.D. in 2013 from Columbia Law School, where he was a James Kent Scholar.

**Rachel Jaffe Mauceri** is a partner with Robinson & Cole LLP in Philadelphia in the firm’s Bankruptcy + Reorganizations Group and has more than 20 years of experience counseling clients in complex corporate bankruptcy and restructuring matters. She participates in all aspects of domestic and international restructurings and has significant transactional and litigation experience in a range of industries, including retail, health care, pharmaceutical, agriculture, energy, automotive, oil and gas, mortgage servicing, real estate and telecommunications. Ms. Mauceri’s recent creditor committee representations have included the chapter 11 cases of Aldrich Pump/Murray Boiler (affiliates of Trane), Mariner Health Central (for which she was named 2024 Legal Advisor of the Year by The M&A Advisor and received its 2024 “Restructuring of the Year” award (\$50MM–\$100MM), and was a recipient of the “Healthcare Restructuring of the Year” award by The Global M&A Network), Mallinckrodt plc and Corp Group Banking S.A. She also has represented companies in pre-negotiated and traditional bankruptcy proceedings as well as out-of-court workouts; represented pension and

health plans in connection with collective bargaining issues and proceedings under §§ 1113 and 1114 of the Bankruptcy Code; advised indenture trustees and second-lien lenders; represented financial institutions in the negotiation and documentation of secured lending facilities; advised stalking-horse and other bidders in distressed and bankruptcy-related transactions; and advised vendors, contract parties and other significant creditors and parties in interest on a variety of bankruptcy-related issues. Ms. Mauceri is president-elect of the Consumer Bankruptcy Assistance Project and is listed in *Chambers* and as a Notable Practitioner in the *IFLR1000*. She received her B.A. in journalism from Ithaca College in 1995 and her J.D. *cum laude* in 2001 from Benjamin N. Cardozo School of Law, where she was elected to the Order of the Coif and was supervising editor of its law review.

**Matthew P. Sorenson** is senior managing director with Development Specialists, Inc. in Los Angeles, where he leads and advises on corporate wind-downs, bankruptcy alternatives and complex asset-monetizations. He has served as assignee for the benefit of creditors in hundreds of matters, been retained to serve on boards during closures, and frequently acts as the remaining officer and director for entities navigating dissolution. Mr. Sorenson has been appointed CEO, CFO, COO and receiver in multiple wind-down engagements and has assisted chapter 11 trustees and receivers with on-site management, real property liquidation, operational and human-resources management, cash and budget oversight, valuation and sales of tangible and intellectual-property assets, preferential and fraudulent-transfer analysis, and final collections of estate receivables. He serves as treasurer of the Los Angeles Bankruptcy Forum and has served on its board for more than a decade. He also is a member of ABI, the California Receivers Forum, the California Bankruptcy Forum and the Turn-around Management Association. Mr. Sorenson received his Bachelor's degree in economics with a minor in business administration from the University of Arizona.