

ABI ASSET SALES COMMITTEE WEBINAR

Let's Make a Deal:

Negotiating the Asset Purchase Agreement in Bankruptcy

Howard A. Cohen
Gibbons P.C.
Wilmington, DE

Mary Joanne Dowd
Arent Fox LLP
Washington, DC

Karin H. Berg
Katten Muchin Rosenman LLP
Chicago, IL

December 10, 2018

Purchase Agreements in Bankruptcy

- More difficult for a buyer to obtain protections by way of representations, warranties and indemnification.
- Holdbacks and escrows are harder to negotiate (creditors demand to know what is the net purchase price).
- Bankruptcy Court approval required.
- Bankruptcy involves a process, with deadlines for filing motions, notices and obtaining approval of sale order.
- Bankruptcy Court generally retains jurisdiction to resolve sale disputes.
- Break-Up Fee/Expense Reimbursement not automatic.
- Procedures required to assume and assign contracts.
- More parties involved in the process.

The Structure of the Asset Purchase Agreement

- **Description of the Deal**
 - Assets being purchased
 - Liabilities being assumed
 - Treatment of Executory Contracts and Leases
 - Purchase Price
 - Payable at Closing
 - Purchase Price Adjustments
 - Purchase price allocation for tax purposes
- **Representations and Warranties**
- **Covenants**
 - general and bankruptcy related
- **Conditions to Closing**
- **Termination**
 - Remedies
- **Indemnification**
- **Miscellaneous**

Purchased Assets

- **Specificity with respect to description of assets is important:**
 - Real Property
 - Intellectual Property
 - Machinery and Equipment
 - Inventory
 - Major Assets when too Numerous to Identify
 - Avoidance Actions
 - Books and Records (personally identifiable information)
- **Who has possession of key assets?**
- **When purchase price is dependent on quantity or condition of assets, dispute resolution procedures should be implemented**

Assumption of Liabilities

Liabilities

- **Liabilities Generally**

- Acquisition of Assets Under a Plan vs. Under Section 363
 - Cherry picking assumed liabilities – Buyer can assume any and all liabilities
 - Priority of claims – Not applicable in a 363 sale
- Be clear which liabilities will be assumed v. excluded
 - Delaware case – Substantial Contribution
- Strategic Considerations for Stalking Horse Bidder in Selecting Liabilities

Assumption of Liabilities

Assignment and Assumption of Executory Contracts and Leases

- **Executory Contracts and Leases**

- Section 365 of the Bankruptcy Code

Definition: A contract under which the obligation of both the debtor and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other. – Countrymen definition

- **Schedule to Asset Purchase Agreement**

- Schedule to Asset Purchase Agreement lists Executory Contracts and Leases to be Assumed
- Ability to Add or Remove Executory Contracts and Leases from Assumed Executory Contract Schedule
 - Negotiated Term
 - Prior to Auction
 - Prior to Closing
 - Hybrid

Assumption of Liabilities

Assignment and Assumption of Executory Contracts and Leases

■ **Debtor Seller's Rights and Obligations**

- Right to assume, assign and reject executory contracts and unexpired leases
- Obligation to cure defaults (or provide for adequate assurance that the defaults will be cured)
- Pay cure costs
 - *Negotiated Term: A buyer can increase value of its bid by assuming the cure costs*
- Rejection
 - *Negotiated Term: Timing of rejection*

■ **Buyer's Rights and Obligations**

- Obligation to provide adequate assurance of future performance
- Pay cure costs if agreed to assume obligation from Seller
- Right to succeed to Seller's rights and obligations under the executory contract or lease

Purchase Price Adjustments and Holdbacks

- **Basic Purchase Price**
 - Payable at Closing
- **Adjustments to Purchase Price**
 - Pre-Closing
 - Post-Closing
 - Holdbacks
 - Holdback by Buyer
 - Escrow of Holdback with Third Party
 - Earn-Out or Bonus
 - Audit
 - Agreed Expert or Consultant
 - Examples
 - Environmental Remediation Costs
 - Inventory Levels
 - Accounts Receivable

Purchase Price Tax Allocation

- **For tax and financial reporting purposes, the value of the consideration given in a transaction must be allocated to the acquired assets and liabilities, with residual going to goodwill**
- **Timing**
 - Outside of bankruptcy this is usually done post-closing
 - In a 363 sale, the allocation might need to be agreed upon pre-closing, especially when the seller might not exist or be in a position to handle post-closing. It is fairly common in a 363 sale to provide for the allocation pre-closing
- **Who Proposes Allocation**
 - In cases with a stalking horse purchaser, the purchaser might deliver the schedule
 - In cases without a stalking horse purchaser, the debtor may propose the schedule

Purchase Price Tax Allocation

- **Impact of Allocation on Other Parties**
 - Allocation has potential to impact recoveries of creditors
 - Secured Creditors want more value allocated to their assets
 - Unsecured Creditors benefit when value is allocated to unencumbered assets
 - DIP Lender will want its lien to attach to all assets
 - Delay in agreeing to allocation schedule may harm all parties
- **Limit Impact of Allocation Schedule**

Representations and Warranties

- **Representations and Warranties are statements of fact and assurances made by the parties that help determine the quality, nature and risks of what is being acquired.**
 - Different Categories: General Matters (i.e., authority of seller, due execution, board approval); Business Matters (i.e., title to assets, financial statements, contracts, current litigation, absence of changes, compliance with laws, SEC compliance, tax, IP, Environmental, etc.).
 - Outside of Chapter 11, the seller will represent and warrant its ability to enter into the transaction and bind itself, with such representations and warranties supported by resolutions, certificates of good standing and sometimes opinions of counsel.
 - In a 363 sale, the Debtor's representations and warranties concerning such matters are conditioned on court approval. Opinions of counsel and board voting records are generally not supplied since the parties rely on the 363 sale process and sale order.
 - Outside of Chapter 11, a seller will provide a list of material contracts and the parties must determine which contracts the buyer wants to be assigned and whether consent must be obtained for the assignment to occur.
 - In a 363 sale, section 365 of the Bankruptcy Code authorizes the Debtor to assume and assign most contracts notwithstanding anti-assignment provisions, subject to payment of a cure amount.
 - Outside of Chapter 11, a seller will usually warrant title to assets and disclose liens. The buyer will perform its own due diligence and the parties will arrange for the release of liens at closing.
 - In a 363 sale, although standard to include representations and warranties about title to assets, the parties generally rely on the sale order to convey the purchased assets free and clear of liens at closing, with liens attaching to the sale proceeds.

Covenants: General

- **Standard Covenants**

- Examples:

- Access to Information, Records and Properties
 - Conduct of Business Pending Closing
 - Amendment of contracts
 - Restricted activity
 - Preservation of records and property
 - Obtaining Consents
 - Material Adverse Changes
 - Employees and Benefits
 - Agreements Following Closing
 - Access to / delivery of purchased assets
 - Further Assurances
 - Notifications

Covenants: Bankruptcy Specific

■ Sale Order

- APA must be approved by the Bankruptcy Court
- Provisions that must be contained in the Sale Order
 - *Must be in form and substance acceptable to Buyer*

■ Bidding Procedures and Auction

- Timing of filing and entry of Bidding Procedures Order
- Provisions that must be contained in the Bidding Procedures Order
 - *Must be in form and substance acceptable to Buyer*

■ Cooperating in Bankruptcy Court Matters

- Buyer's review of drafts of motions, applications, pleadings, schedules, reports, etc. relating to the Sale.
- Notice Requirements (to be detailed below)
- Objections – Who will handle – The Debtor Seller or the Buyer
- Appeals – What happens in an appeal is filed?
- Motion to amend case caption

Covenants: Bankruptcy Specific

■ Break-Up Fees and Expense Reimbursement

- Break-up fees act as a type of liquidated damages clause, compensating the stalking horse purchaser most frequently when a higher bidder closes on the sale of the purchased assets. Expense reimbursements are meant to reimburse the stalking horse bidder for actual out of pocket expenses associated with due diligence and documenting the purchase agreement.
- Outside of Chapter 11, such fees are reviewed under the business judgment rule, whereas in bankruptcy, such fees must be approved by the Bankruptcy Court and may be subject to reconsideration after the fact (i.e., Energy Futures).
- A Break-up fee of 2-3% is common in bankruptcy.
- Negotiation concerns not only the amount of the fee, but timing of payment and the priority of the claim.

■ No Shop / No Talk Provisions

- **Timing**
 - Pre-Bankruptcy Filing / Entry of Bid Procedures Order v. Following Entry of Bid Procedures Order
- **Rare But Not Prohibited**
 - *In re Los Angeles Dodgers*, 465 B.R. 18 (D. Del. 2011)
- **Unusual Circumstances**
 - Necessary to obtain a sale
 - Consistent with Debtor's fiduciary duties
 - Do no chill bidding process

Covenants: Bankruptcy Specific

■ Notice Requirements

- **Bankruptcy sales of assets and assignments of unexpired leases and executory contracts must be properly noticed**
 - Bankruptcy sales free and clear of liens must be served on lien holders
 - Certain notices, for example, to lien holders and to counter-parties to leases and contracts to be assumed and assigned must be served as one would a summons and complaint (must identify officer or managing agent, cannot simply mail to company)
- **Responsibility:** Seller is responsible for providing notice to creditors and parties in interest
- **Schedules to APA:** Buyer could require APA to include schedules listing the notice parties, or require Seller to obtain Buyer approval of all notices and give Buyer the right to require additional notices
- **Publication Notice**
 - The APA could provide for publication notice
 - Publication notice is appropriate where there are possible unknown creditors (mass tort, sexual harassment, environmental)

Conditions to Closing

- **Buyer and Seller Reps and Warranties True**
 - Expire at Closing
- **Buyer and Seller Covenants Performed or Waived**
 - Regulatory Approvals
 - HSR
 - FCC
 - State or Local Licenses
 - Bankruptcy Orders Entered
 - Consents to Contract Assignments Obtained
 - Amendments to Contracts or Licenses Obtained
- **No Material Adverse Changes**
- **No Injunctions**
- **Resolution of Pending Litigation**

Termination

- **By Mutual Agreement**
- **By Buyer or Seller** if either is in Material Breach of Reps and Warranties or Covenants
- **By Buyer if**
 - Conditions to Closing Not Met
 - Bankruptcy Related Covenants Not Met
 - Regulatory Approvals Not Obtained or Unlikely to be Obtained by Date Certain
- **By Seller**
 - Conditions to Closing Not Met

Remedies on Termination

- **Mutual Termination**

- Usually no penalty, unless negotiated
- Buyer's deposit returned

- **Buyer Terminates**

- If for cause:
 - Buyer's deposit returned
 - Damages Unlikely
- If not for cause:
 - Negotiable. Cap damages at deposit or unlimited damages.

- **Seller Terminates**

- If for cause:
 - Seller retains Buyer's deposit
 - Damages

Indemnification

- **Indemnification for breaches of Reps and Warranties not standard**
- **If there is an indemnity provision, to collect you need**
 - A holdback, or
 - An allowed administrative expense claim against the bankruptcy estate