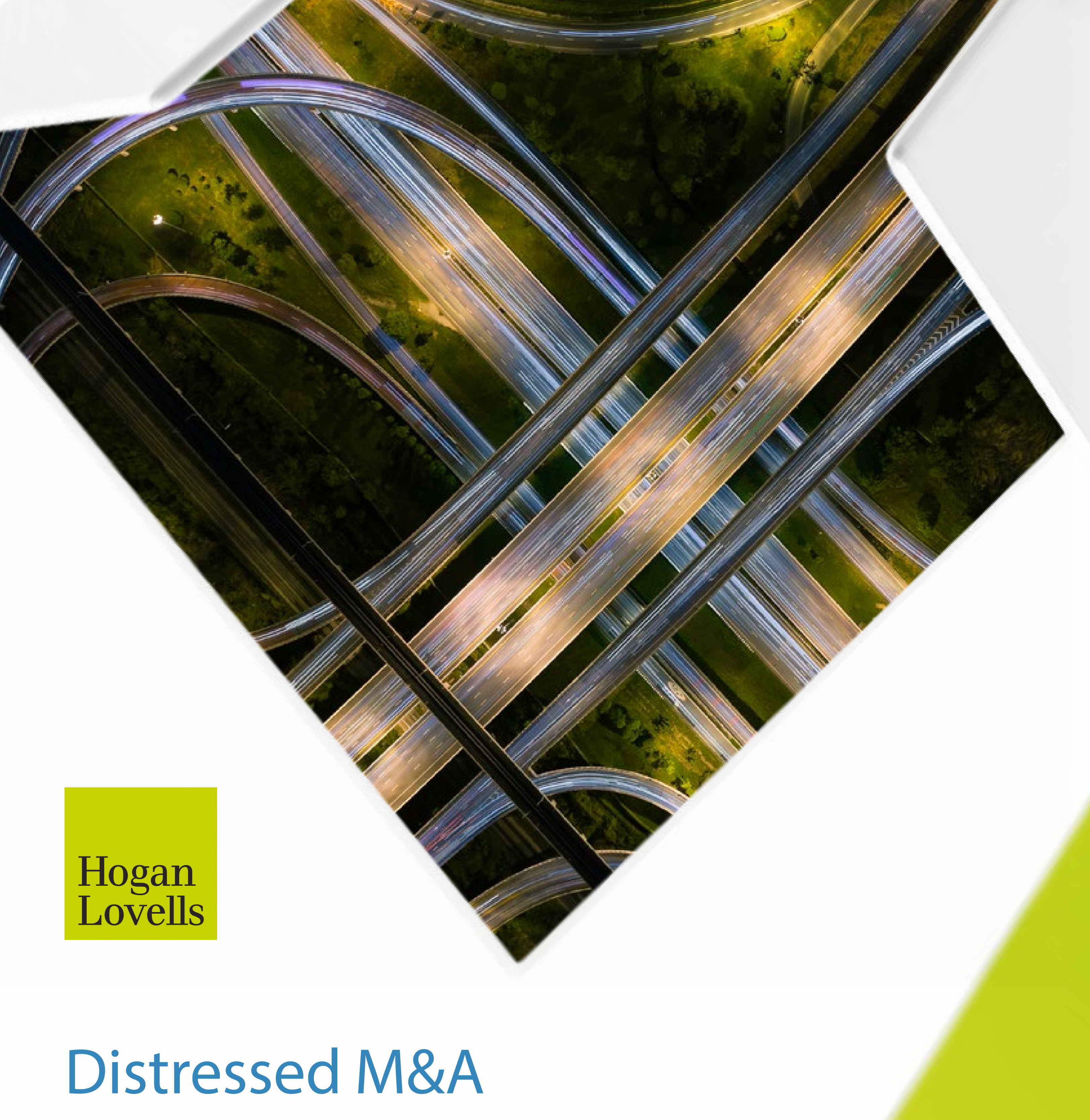


Distressed M&A

United States

Contents

04 | Distressed M&A in the U.S.

06 | Our capabilities

08 | Our experience

10 | Key considerations in the U.S.

12 | Out-of-court sales

16 | U.S. bankruptcy proceedings

26 | Intellectual property

28 | Misconceptions in the U.S.

Distressed M&A in the U.S.

Hogan Lovells is a leading M&A advisor in the United States with extensive experience in distressed M&A transactions.

Our Distressed M&A practice is comprised of members of our top ten ranked U.S. M&A team and our market-leading Business Restructuring and Insolvency team (BRI).

Our M&A and BRI teams have worked together extensively on distressed M&A transactions, allowing us to offer sophisticated, coordinated support on behalf of financial and strategic buyers of, and investors in, distressed M&A assets.

Clients engage our team of experts to help navigate the complex journey of acquiring troubled assets. We understand the unique combination of business, regulatory, and legal challenges that arise in these transactions, both inside and outside of insolvency proceedings.

Across industry sectors, we provide our clients with a team-oriented, collaborative approach that offers a full spectrum of legal services necessary for executing restructuring transactions, including debt finance, labor and employment, tax, antitrust, environmental, intellectual property, real estate and employee benefits.

Contents

06 | Our capabilities

08 | Our experience

Our capabilities

Executing transactions effectively

Our Distressed M&A team of over 125+ M&A and BRI lawyers is skilled in guiding our clients from structuring a distressed transaction as either a material asset acquisition or investment opportunity through closing.

In providing our advice, we partner with our clients to evaluate acquisition and investment opportunities and assess risks across asset classes and capital structures in insolvency proceedings and out-of-court deals.

Successfully executing distressed M&A transactions requires a full understanding of bankruptcy court procedures and skillful handling of the complex interplay between corporate and bankruptcy transactions.

Hogan Lovells' experienced dealmakers provide a cohesive team to our clients, drawing on the subject matter knowledge of colleagues across practices, including to ensure compliance of any transaction with securities and antitrust laws and regulatory regimes, compensation and benefits requirements, and post-M&A closing proceedings.

We have guided numerous clients in transformative deals through distressed M&A transactions that have empowered weakened or failing operations to become prosperous ventures.

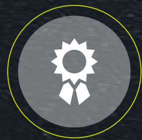
Areas of focus

- Mergers
- Asset and stock purchases
- Chapter 11 plans of reorganization
- Asset sales pursuant to 11 USC § 363
- DIP and "bridge" credit facilities
- Credit bidding
- Stalking Horse purchase agreements
- "Loan-to-Own" Strategies
- "Exit" financing
- Debt for equity swaps
- Business structure evaluation
- Conduct dispute resolution
- Valuation of core and non-core assets
- U.S. regulatory issues
- Receiverships under federal or state law
- Reorganization planning
- Enforcement of security agreements
- IP acquisitions and dispositions

Healthcare/Life Sciences Deal of the Year

for the sale of Orexigen Therapeutics (< US$500m)

The M&A Advisor Turnaround Awards, 2018



Sec. 363 Sale of the Year

for the Sec.363 sale of Abengoa SA (> US$250-$500m)

The M&A Advisor Turnaround Awards, 2017

Chapter 11 Reorganization of the Year

for the Chapter 11 reorganization and restructuring of KalosBios Pharmaceuticals (US$10-25m)

The M&A Advisor Turnaround Awards, 2017

Our experience

Anschutz and Starwood

Representation of Anschutz and Starwood as bidders and acquirers of the Sea Island Company in a Section 363 bankruptcy sale in District of Georgia bankruptcy court.

Harbinger Capital Partners

Representation of Harbinger Capital Partners in its purchase of power assets from Calpine Corp. in connection with Calpine's Chapter 11 case and its Section 363 acquisition of Southaven Power, an 810 MW natural gas-fired electric generation facility located in Southaven, Mississippi.

ID Logistics

Representation of ID Logistics in its acquisition of Jagged Peak, a logistics services company specializing in e-commerce, multi-channel and consumer products based in Tampa, Florida.

KaloBios Pharmaceuticals

Representation of KaloBios Pharmaceuticals (now known as Humanigen Inc.) in its Chapter 11 cases, where we successfully negotiated an acquisition of rights to a valuable drug in the middle of Chapter 11 –a very rare feat in Chapter 11 bankruptcies.

Lockheed Martin

Representation of Lockheed Martin as DIP Lender and successful Stalking Horse bidder for certain IP assets of satellite launch technology company, Vector Launch, in Vector Launch's chapter 11 cases.

Scottish Re

Representation of Scottish Re in the implementation of a sale and restructuring plan for its Cayman Islands subsidiary, Scottish Annuity & Life Insurance Company (Cayman) Ltd. (SALIC), and SALIC's U.S. subsidiary, Scottish Holdings, Inc.

Supercanal SA

Representation of CVI Austral LLP on its US$250m acquisition of Grupo Vila-Manzano's interest in Argentine cable television and internet provider Supercanal SA, which filed for Chapter 15 protection in the Southern District of New York.

Velocys

Representation of Velocys as Stalking Horse bidder and DIP lender in connection with the proposed purchase of a gas-to-liquid facility in Louisiana and related energy assets in Chapter 11.

Band 1

Highly Regarded
Nationwide M&A
Chambers USA, 2020

Top 5

Restructuring law firm
by number of jurisdictions
Chambers Global, 2020

Most Innovative Firm

Financial Times Innovative Lawyer Awards. 2019

Key considerations in the U.S.

Guiding you through complexities.

Our Distressed M&A team works with financial and sponsor clients across industries and understands that each restructuring transaction presents unique issues and often exceptional challenges requiring a customized approach.

It is critical for distressed sellers and buyers to take early and proactive steps to formulate and implement clear strategies designed to maximize optionality, leverage and control in order to achieve the desired outcome and reduce the likelihood of subsequent attacks on a distressed transaction.

In the following pages, we offer a guide to the various in-court and out-of-court structures and processes for distressed M&A in the United States.

Contents

---

12 | Out-of-court sales

16 | U.S. bankruptcy proceedings

- 16 | Sales under Section 363 of the U.S. Bankruptcy Code
- 24 | Chapter 11 plan sales

26 | Intellectual property

Out-of-court sales

Distressed Acquisitions Outside of Court

Distressed acquisitions can be and often are implemented outside of court due to the expense of court proceedings, particularly proceedings under Chapter 11 of the U.S. Bankruptcy Code. Even when a buyer and seller opt to implement a distressed acquisition outside of court, it is important they understand the benefits and challenges of an out-of-court approach compared to in-court transactions. Such understanding will inform the negotiations between the parties, the buyer's due diligence efforts, and the drafting of operative documentation.

Benefits and challenges

In certain circumstances, conducting out-of-court distressed acquisitions or investing out-of-court in distressed M&A assets can offer advantages over pursuing a bankruptcy sales process. Potential benefits of an out-of-court transaction include:

- avoiding the considerable costs, delays, and public nature of a bankruptcy process;
- bypassing bankruptcy notice and auction requirements;
- circumventing the need to cooperate with creditors' committees or other parties that could seek to block the approval of the sale;
- maintaining control of the sales process and the timing of the sale;
- avoiding the need for approval from a bankruptcy judge and receiver; and
- avoiding the multiparty negotiations with secured and unsecured creditors that are common in bankruptcy.

However, out-of-court buyers and investors face two key challenges that buyers and investors in bankruptcy proceedings do not:

- transactions may be attacked as fraudulent conveyances under state law or in a subsequent bankruptcy of the seller; and
- buyers cannot always fully insulate themselves from potential successor liabilities.

[B]esides a strong technical ability, they are incredibly client-focused and very responsive.

Chambers USA, 2019

They are very adept at looking at issues not just from a legal perspective but also from a commercial, reputational, and risk and regulatory perspective.

Chambers Global, 2020

Process and procedures

While the process to consummate an out-of-court distressed M&A transaction will be similar to a traditional M&A transaction in many respects, there are certain key differences.

The distressed company may have far less time to implement a transaction in a distressed M&A situation and therefore insist on a truncated process, including shortened and more focused diligence, fast-paced negotiations and expedited execution of definitive documentation.

In addition, much of the transaction structure for a distressed M&A deal will be influenced by considerations of potential down-side risks, such as the risk of subsequent attacks on the transaction as a fraudulent transfer by creditors.

Structure also may be impacted by how a subsequent bankruptcy filing by the distressed company could affect the transaction, including from an implementation standpoint if the acquirer requires ongoing transition services from a distressed company.

Key aspects of out-of-court sales

While an out-of-court acquisition may provide a buyer with additional flexibility than an acquisition made in a bankruptcy proceeding, the out-of-court acquisition of a distressed target or distressed assets presents unique challenges and uncertainties. Certain key aspects of out-of-court sales – critical for a buyer to consider and also important for a seller to understand – are set forth below.

Transaction structure

- A buyer may prefer to structure a distressed M&A transaction as an asset sale rather than an equity sale, so that the buyer can choose which assets and liabilities to acquire and which to leave behind.
- The potential tax consequences that might make a seller prefer an equity sale over an asset sale in the traditional M&A context likely are decreased where the target is distressed (e.g., fewer gains and greater losses to offset them).
- Even in an asset deal where a buyer assumes only specifically listed liabilities, the buyer in a distressed sale should be aware of any material excluded liabilities, as the buyer could find itself liable even for excluded liabilities under a successor liability theory.
- On the other hand, equity sales may still be preferred where assets are located across multiple jurisdictions, as such transactions can often be completed more quickly than asset sales.

Accelerated timeline

- Time is of the essence for a distressed M&A seller. If the target's business is rapidly declining, the seller will be incentivized to move quickly to preserve transaction value.
- The accelerated timeline frequently seen in distressed M&A may pose challenges, including that the need for speed may limit the pool of potential buyers to those that have experience in fast-paced transactions and are willing and able to adapt to significant time pressures.

Due diligence

- One of the first places an accelerated timeline may become apparent is in the due diligence process where a buyer must be prepared to complete its due diligence review in a reduced timeframe.
- A buyer may face challenges with due diligence as a result of the target's distress, including inability to conduct a fulsome review and have visibility into the target's finances and other books and records as a result of departing employees.
- A buyer may encounter more significant due diligence issues with a distressed target than might appear in a traditional M&A sale.
- The buyer should perform due diligence not only on the causes of the distress, but also on the results of the distress; e.g., whether the target is keeping its assets in good condition, investing in capital expenditures, taking care of employees and maintaining good relationships with customers, suppliers and other third parties.

Third-party communications and consents

- A buyer of distressed assets may be more likely to need to communicate with third parties, including customers, suppliers, lenders, and lienholders, than a buyer in a traditional acquisition. Good relationships with third parties may be critical to ensuring the target's success post- closing.
- Especially in a distressed asset sale, the consent of third parties may be required to assign contracts to the buyer and to remove liens or other encumbrances on the assets.

Antitrust analysis

- A buyer should analyze early in the transaction process whether any antitrust filings and approvals are required in connection with the transaction.
- Depending on the jurisdictions involved, the approval process can be long, cutting against a desire to sign and close a transaction quickly and requiring the parties to comply with pre-closing obligations in the purchase agreement for a potentially extended period.

Post-closing recourse and arrangements

- A distressed seller may not be able to satisfy indemnification claims after closing. A buyer should consider whether the up-front purchase price reflects this potential lack of post-closing recourse from the seller.
- The buyer also should consider including other protections in the purchase agreement, such as a guarantee by a creditworthy affiliate of the seller or an appropriate escrow.
- A buyer may want to obtain representation and warranty insurance ("RWI"). While RWI typically has been more limited in the distressed M&A context, insurers are increasingly likely to offer coverage in instances where substantial due diligence has been conducted.
- The seller's ability to provide post-closing transition services or fulfil other post-closing obligations may be limited.

Risks to transaction certainty

- In out-of-court sales, a buyer may face third-party challenges to the sale during the transaction process or even after closing.
- In addition, if the seller files for bankruptcy protection after signing, the seller may choose to reject the purchase agreement before closing and sell at auction to another bidder, denying the buyer the benefits of the bargained-for purchase agreement.
- Creditors of the seller could bring future claims against the buyer that the sale was a fraudulent transfer, with the goal of unwinding the sale. The buyer should take steps to mitigate this risk, including to document that fair consideration was paid and to consider obtaining a fairness and solvency opinion from a qualified investment bank.

U.S. bankruptcy proceedings

There are two key in-court processes for the acquisition of distressed assets under U.S. Bankruptcy law – sales under Section 363 of the U.S. Bankruptcy Code (described on pages 16 - 23) and Chapter 11 reorganization plan sales (described on pages 24 – 25).

Sales under Section 363 of the U.S. Bankruptcy Code

Section 363(b) of the U.S. Bankruptcy Code permits debtors to sell assets out of the ordinary course (a "363 Sale"). Specifically, Section 363(b) states as follows:

"The trustee (or debtor in possession) after notice and a hearing, may use, sell, or lease other than in the ordinary course of business, property of the estate."

Benefits and challenges

In certain circumstances, participating in a 363 Sale will offer advantages over pursuing an out-of-court transaction. Potential benefits of a 363 Sale include:

- The fact that a court ultimately approves every part of a 363 Sale makes this type of sale the cleanest from a buyer's perspective.
- Although court approval is required for a 363 Sale, stockholder approval is not required.
- A 363 Sale is done on notice to all parties in interest so potential problems will arise and likely be addressed prior to the sale being consummated.
- A buyer can designate the specific assets that the buyer desires to purchase and the specific liabilities that the buyer is willing to assume.
- The assets are transferred free and clear of liens, claims, and encumbrances (i.e. clean title).
- Bankruptcy courts will typically require a marketing or auction process to maximize value in a 363 Sale.
- Unlike a sale consummated under a debtor's Chapter 11 plan, a 363 Sale does not require creditor voting.
- Officers and directors generally are protected from stockholder and creditor claims because of court approval, as creditors and stockholders can raise objections and concerns prior to court approval.
- Executory contracts generally can be assigned regardless of any anti- assignment provisions except for certain key exceptions where applicable non-bankruptcy law excuses the contract party from accepting performance from or rendering performance to an entity other than the debtor (e.g., personal services contracts, IP licenses, governmental contracts and partnership/LLC agreements).

However, in some instances a 363 Sale can bring the following challenges:

- A 363 Sale is potentially more costly and time consuming than an out-of-court transaction.
- Purchase offers will be subject to a robust market test for higher and/or better offers.
- The 363 Sale process is transparent and nearly all aspects of the sale (including terms and conditions of the operative documents) will be publicly available.

Process and procedures

In order for a debtor to sell its assets pursuant to Section 363, the debtor must show that the sale "maximizes value" for the company's stakeholders. Whether a sale "maximizes value" can depend on a number of factors, including timing of the sale, the consideration to be paid by the buyer (including assumption of liabilities), the buyer's ability to close (including potential regulatory hurdles), and the impact on employees.

The best way for a debtor to establish that a sale "maximizes value" is to have the court approve not only the final sale, but also to pre-approve the debtor's process for marketing and selling the assets.

Therefore, debtors typically will seek court approval of "bidding procedures" and the "auction process" prior to commencing the sale process.

If a buyer is active early in the process, it can position itself as the stalking horse purchaser and negotiate with the debtor regarding the specifics of the bidding procedures and the auction process. The buyer who has a seat at the table when the process is developed can influence issues of timing, bidding requirements and acquisition structure, among other things, in a manner that will likely provide it a distinct advantage over other bidders.

Section 363 Sale proceedings

Section 363 Sales can proceed with the debtor seeking an initial bid from a "stalking horse" bidder or without a stalking horse in a so-called "naked auction." Debtors often prefer the certainty of a stalking horse and a stalking horse may be advantageous to bidders as well.

Stalking Horse Process

Debtors often will seek an initial bid on the relevant business or assets from a "Stalking Horse" bidder prior to filing the bankruptcy action.

If the debtor identifies a Stalking Horse, the debtor will agree on a form asset purchase agreement (APA) with the Stalking Horse and then file a motion seeking court approval of the Stalking Horse's APA as the "floor bid to bid against." The debtor also typically seeks approval of a break-up fee and expense reimbursement for the Stalking Horse, as well as the bid procedures for the sale process (which will have been previously negotiated with the Stalking Horse).

The bid procedures often will include the requirements for access to a data room for legal diligence and the minimum purchase price required to beat the Stalking Horse's bid (called the initial "topping bid"), which often is the sum of the total Stalking Horse's consideration, plus the amount of the bid protections (e.g., break- up fee and expense reimbursement), plus a minimum "overbid amount".

The bid procedures also often specify a cash deposit that a competing bidder must submit (often 10% of the Stalking Horse's bid price).

Naked Auction Process

If the debtor is running a sale process without a Stalking Horse—a so-called "naked auction"—the debtor will ask the court to approve the proposed sale process and a form of APA. The debtor also may reserve the right to return to the court for approval of a Stalking Horse if one emerges or in some rare instances for the court to even preapprove protections for a future Stalking Horse (including, potentially, pre-approval of a termination fee, expense reimbursement, bid protections, etc.).

Because the debtor unilaterally drafts the form APA and implements the bidding procedures in a naked auction, the debtor is likely to provide itself significant flexibility and implement a very open marketing process. In some situations this may be advantageous from the debtor's perspective, but from a bidder's perspective this creates a greater potential that the process is modified during the process or that other bidders create a bidding war for the assets.

In the event of either a Stalking Horse or a Naked Auction, obtaining court approval of these procedures helps to ensure that the ultimate sale will contain the provisions necessary to provide adequate comfort to the buyer and seller.

Hogan Lovells results

Case studies

Stalking Horse

In connection with the bankruptcy of an Enron-affiliated deregulated energy business, Hogan Lovells represented a NYSE-listed Midwestern energy company as the Stalking Horse bidder for the acquisition of key strategic assets.

We organized a broad-based team of M&A, bankruptcy, commercial and energy regulatory attorneys in a fast paced and ever changing auction process.

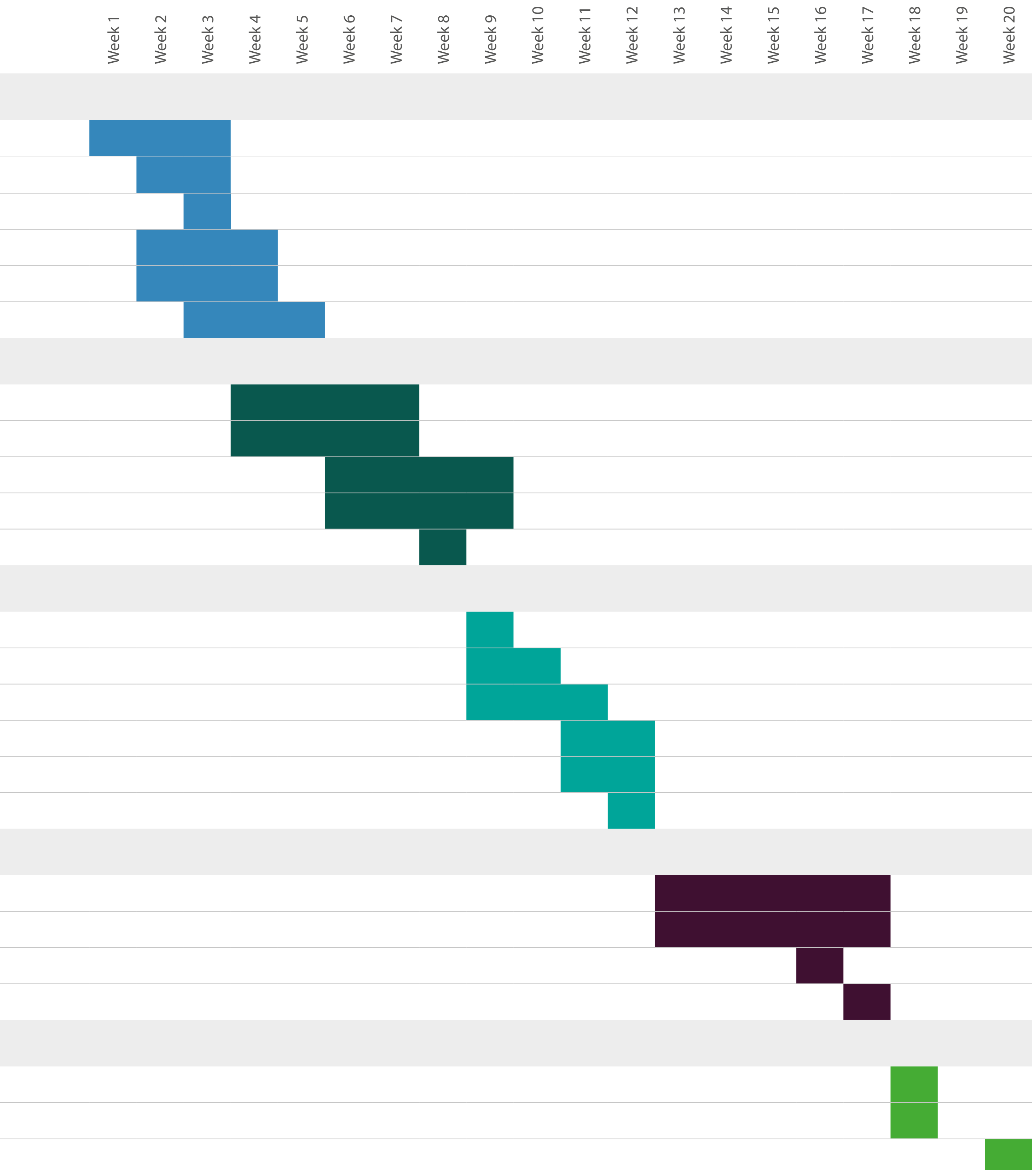
Naked Auctions

In connection with the sale of Orexigen Therapeutics, Hogan Lovells advised the debtor on its implementation of a "naked" sale process that permitted the debtor to return to the bankruptcy court on an expedited basis to seek approval of Stalking Horse protections if a Stalking Horse were to subsequently emerge.

After a few weeks of the sale process, the debtor successfully obtained a Stalking Horse bid and, given the pre-approval that had been obtained, was able to receive expedited court approval of Stalking Horse protections. Our client ultimately successfully sold its assets to the Stalking Horse bidder.

Customary timing

Preparation
Investment Bank Performs Due Diligence
Prepare and Finalize Investor List
Prepare Executive Summary (“Teaser”)
Assemble Potential Investor Data Room
Draft Confidential information Memorandum
Prepare Management Presentation
Solicitation
Contract Potential Acquirors
Execute Confidentiality Agreements
Distribute Confidential Information Memorandum
Manage Data Room & Investor Due Diligence Process
Initial Indications of Interest Deadline & Evaluation
Negotiation
Select Investors to Participate in Next Round
Conduct Management Presentations
Conduct Final Due Diligence
Solicit & Evaluate Final Bids
Document Stalking Horse Agreement
Final Stalking Horse Agreement & Proposed Bid/Sale Procedures
Re-market
Contact Potential Overbidders to Participate in Auction
Contact Management Presentations for Potential Overbidders
Sale Procedure Hearing
Final Bid Deadline
Auction & Close
Auction
Sale Hearing
Close


Week 1
Week 2
Week 3
Week 4
Week 5
Week 6
Week 7
Week 8
Week 9
Week 10
Week 11
Week 12
Week 13
Week 14
Week 15
Week 16
Week 17
Week 18
Week 19
Week 20

Credit Bidding

In the event of a 363 Sale through an auction process, a secured creditor can bid some portion of the secured debt held by the creditor. The amount (value) of the bid is equal to the face amount of the debt that is bid (plus any cash or other assets which are included in the bid), regardless of what the secured creditor paid for debt (e.g., if creditor paid 50 cents on the dollar to own the secured debt, it still is permitted to bid the full amount of the secured debt).

- Section 363(k): At a 363 Sale of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise, the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

Credit bidding is a strategy sometimes used by opportunistic lenders looking to implement "loan to own" strategies, and has become more popular recently. Credit bidding can also be used as a defensive strategy to prevent below market value sale of a secured creditor's collateral.

- Purchasing pre-bankruptcy secured debt at a discount may be an advantageous way to acquire assets out of bankruptcy at a reduced price because the full face amount of the debt can still be credit bid.
- Banks are sometimes willing to sell their secured positions at a discount to avoid involvement in a bankruptcy process, whereas (financial buyers) are typically much more willing to hold onto their secured debt and attempt to direct the outcome of the (sale process).
- A Stalking Horse bidder sometimes provides the debtor "debtor in possession" (DIP) financing, which allows the bidder, in its capacity as DIP lender, much greater control over the sale process, including the timing thereof and the terms of the bidding procedures.
- Additionally, if the debtor lacks sufficient capital to even fund the cost of preparing, filing and administering a bankruptcy case to implement a proposed sale transaction, the bidder can provide pre-bankruptcy "bridge" financing to provide the debtor sufficient liquidity to file and administer its bankruptcy case. Once in bankruptcy, the bidder is also able provide additional DIP financing in the bankruptcy case and "roll-up" some or all of the bridge loan into the DIP facility to gain advantage of the same protections afforded DIP facilities under the Bankruptcy Code.

Potential Limitations

The United States Supreme Court – in a unanimous decision in RadLAX Gateway Hotel v. Amalgamated Bank – reaffirmed the ability of secured creditors to credit bid in the sale of their collateral pursuant to a plan under Section 363(k). But courts have found that the right to credit bid is not unqualified and can be reduced or eliminated for "cause".

- The secured creditor cannot credit bid for assets that are not its collateral.
- The secured creditor must avoid acting in bad faith, colluding or trying to rush or compromise the sales process.

Select outlier cases:

- Fisker Automotive - credit bidding was limited to the amount paid for the debt because the Court ruled that it otherwise would chill bidding.
- Free-Lance Star - court curtailed credit bidding rights because (i) the secured creditor's lien was not fully secured; (ii) the secured creditor had an "overly zealous" loan-to-own strategy; and (iii) the secured creditor's misconduct had a negative impact on the auction process.

Hogan Lovells results

Case study

In the bankruptcy case of Vector Launch, Hogan Lovells advised Lockheed Martin in its acquisition of the IP assets of a bankrupt start-up satellite and rocket manufacturing company, which required a bankruptcy process to implement the sale because the debtor was unable to obtain the requisite shareholder approvals to implement the transaction out-of-court.

Lockheed Martin provided a bridge loan to the debtor, rolled up the bridge loan into an additional DIP facility in the bankruptcy case, served as Stalking Horse for the proposed sale process, and ultimately credit bid the DIP and bridge loans, along with additional cash consideration, in its successful purchase of the IP assets.

Chapter 11 plan sales

A Chapter 11 plan can effectuate a distressed transaction by providing for an asset sale to be implemented through the plan or provide for an acquisition structured as a recapitalization where the acquirer will serve as the plan sponsor and infuse new capital into the debtor in exchange for the debtor issuing new equity interests to the acquirer.

Benefits and challenges

An acquisition through a debtor's Chapter 11 plan has many of the protections (court approval, free and clear, etc.) of a 363 Sale and has certain unique benefits, including:

- The potential to obtain releases from third parties;
- It may be easier for the debtor to retain personnel;
- An ease of acquiring or retaining the debtor's causes of action; and
- Transfer and other tax issues may be eliminated and NOLs and other tax attributes may be preserved.

However, in some instances an acquisition through a debtor's Chapter 11 plan is disfavored because:

- In order to consummate a Chapter 11 plan acquisition, the debtor has to obtain approval of a disclosure statement, then solicit votes and obtain confirmation of the plan.
- During the confirmation process, the debtor will continue to bear the carrying cost or cash burn rate of running the business, as well as the cost and time to prepare the disclosure statement, plan, and solicitation materials, and conduct the vote.
- The confirmation process is not a guarantee. There is a risk that the plan might be delayed or not approved by the court, there are potential further losses of business and/or customers during the plan process, and there is a potential for heightened scrutiny by the committee of unsecured creditors (which is appointed by the U.S. Trustee to represent the interests of all unsecured creditors), secured lenders, individual unsecured creditors and any other party-in-interest.

> Accomplished team acting for an array of clients from debtors and purchasers to creditors and committees. Adept at acting for companies in the financial, retail and healthcare spheres. Expertise includes Chapter 11 cases and out-of-court restructurings.
>
> Chambers USA, 2019

Process and procedures

If a debtor pursues a sale through a Chapter 11 plan, the Debtor is required to file a plan during the first 120 days post-filing for Chapter 11 (but that time period can be, and is often, extended by order of the bankruptcy court).

The Chapter 11 plan provides for the treatment of each class of creditors and is accompanied by a disclosure statement containing "adequate information" on the substance of the plan to be sent to creditors to solicit their vote on the plan.

"Unimpaired" creditors do not vote and are deemed to have accepted the Chapter 11 plan. "Impaired" creditors may vote on the Chapter 11 plan. For a Chapter 11 plan to be confirmed consensually, 2/3 in amount and 1/2 in number from each impaired class must vote to confirm the plan. However, the Chapter 11 plan can be confirmed even if one or more classes vote to reject the plan so long as at least one impaired class of claims has accepted the plan and the plan satisfies certain other requirements of the Bankruptcy Code, most notably that the plan is fair and equitable and does not unfairly discriminate between creditors.

In that case, the Chapter 11 plan will be "crammed down" on all dissenting classes. Importantly, absent a consensual plan, (equity interests cannot receive or retain any value on account of their equity interests) under the plan unless all creditors are paid in full.

If the Chapter 11 plan is confirmed, the company will emerge from bankruptcy as a reorganized company pursuant to the terms of the plan.

The plan process may take as short as 45 days to six months if highly contested and/or multiple plan modifications occur. On average, the plan process will likely last three months from filing of the plan to confirmation of the plan.

If the debtor and its key constituents (typically, any secured lenders) are agreeable prior to bankruptcy on a proposed plan process, the process maybe sufficiently streamlined by filing the proposed plan on the first day of the bankruptcy case. In such cases, term "pre-packs" have become increasingly popular and are an effective means to achieve the benefits of the Chapter 11 process while minimizing the costs typically associated with Chapter 11 due to the short time frame that the debtor company is actually in bankruptcy. Typically, however, these pre-packs leave trade debt unaltered and only effectuate a balance sheet restructuring because trade creditors are often too numerous to negotiate global resolutions in advance of the bankruptcy filing.

Intellectual property

Technology and intellectual property (IP) assets are critical to businesses of all types. IP can be the foundation of the products and services of the business and the source of its competitive advantage.

- Acquisitions of IP assets outside of bankruptcy face fraudulent conveyance risk, even if the buyer is obtaining license rights rather than ownership. An acquisition through a bankruptcy process eliminates this risk.
- The trustee or debtor in possession in bankruptcy can reject and terminate many contracts, but licensees of intellectual property have special status. Section 365(n) of the Bankruptcy Code provides a mechanism for licensees to retain their rights under licenses to the debtor's IP. This means that a buyer may acquire IP assets subject to the encumbrance of existing licenses, which may diminish the value of the IP.
- If a distressed acquisition involves splitting up an enterprise among different buyers, there will likely be IP that is "shared" by multiple businesses, and the buyers will need to negotiate licensing and services arrangements relating to that shared IP.
- In software and other technology industries, it is not uncommon for an IP provider to agree to place software source code and other trade secret information into a third party escrow arrangement, to be released on certain events, often including bankruptcy and insolvency. A debtor's source code and other trade secrets may be subject to release, or parties may face legal battles to try to prevent release.
- The debtor may be a licensee of critical IP assets, such as customized software, product components, or data. The trustee generally has the power to assume executory contracts and assign them to a buyer, but there are limits, including with respect to contracts that would not be assignable under non-bankruptcy law. Nonexclusive licenses of IP are generally not assignable, but negotiated exceptions are common.
- Effectively using and exploiting IP assets often depends on securing the services of technologists with key know-how and experience. If those people are unavailable or unwilling to stay with the business, the value of the IP assets could be diminished.

The Hogan [Lovells] team works well together to provide excellent client service and legal advice. The quality of their services is top notch.

Client testimonial, Chambers and Partners, 2020

Matters of all shapes and sizes are dispatched efficiently and effectively; it is little surprise that so many of the world's biggest companies are loyal patrons

IAM Patent 1000, 2019

Hogan Lovells results

Case study

Our bankruptcy, finance, M&A, and IP transactional lawyers teamed up to assist our creditor consumer electronics client in connection with a distressed technology company.

Our team coordinated seamlessly in a very fast-moving project to simultaneously prepare for the possibility of a bankruptcy filing and a distressed acquisition, negotiate credit arrangements, diligence key IP assets and encumbrances, and negotiate a potential licensing arrangement—all to help our client be prepared for multiple possible outcomes.

Misconceptions in the U.S.

With our full service offering, the Hogan Lovells team can guide you through the misconceptions and complexities of distressed M&A transactions and help you to achieve your business goals.

Misconception:

Distressed M&A counsel is needed only when a target files for bankruptcy or a bidder has decided to participate in a bankruptcy process.

The Truth

Interested buyers that are able to control the parameters of a distressed M&A process have a significant advantage (both in terms of available options and leverage) over bidders who simply submit a competing bid at auction.

Therefore, it is crucial for potential bidders to involve distressed M&A counsel as early as possible to consider and preserve a number of options relating to the distressed M&A opportunity, including credit bidding and participating in out-of-court processes, either alone or with other potential buyers.

Early involvement also can allow a bidder to set the pace for a potential bankruptcy process and through engagement with other stakeholders gain valuable knowledge about the key assets and workforce of the target.

Misconception

Being a Stalking Horse does not provide many advantages because a bidder can only get a three to five percent break-up fee, which is small compensation for the time and effort if you lose the deal.

The Truth

In reality, being a Stalking Horse has many advantages beyond the potential for a break-up fee.

Most notably, a Stalking Horse can (1) require a fast transaction time table, making it difficult for other bidders to compete in a thoughtful and competitive way, and (2) set the bidding procedures.

This can be particularly useful where a Stalking Horse is interested in only a subset of the assets, as the Stalking Horse can require that bids be submitted in "lots" and mandate that the Stalking Horse's bid be deemed conforming and given due consideration even if other buyers come forward for substantially all of the assets.

With Hogan Lovells, we know we've got strong advocates and expertise on our side.

Chambers USA, 2019

Misconception

Because of the anti-collusion provisions of the U.S. Bankruptcy Code, it is impossible for bidders to consider joint bids for assets in bankruptcy. If the buyer can't or won't buy the entire asset, then there's no point in participating in the sales process.

The Truth

While there are anti-collusion provisions in the U.S. Bankruptcy Code, these provisions only apply once the seller is in bankruptcy, so considering a joint bid to split up the assets can be pursued prior to a bankruptcy filing.

Once the case has been filed with a bankruptcy court, a buyer can still work with another potential bidder, but would need to do so with the consent of the debtor.

While such debtor consent sometimes can be difficult to obtain, the bankers running the sales process almost always are looking for more bids and if neither bidder is likely to bid on its own, the bankers will almost always encourage their debtor to allow for consortium-type bidding groups to participate.

Misconception

If a seller/debtor is out of cash and is not able to obtain traditional DIP financing, completing an asset sale in a Chapter 11 would be impossible and so the sale isn't going to happen.

The Truth

In reality, buyers in a 363 Sale can also be DIP lenders, and can "credit bid" their DIP loan as part of the purchase price.

Because the DIP loan will likely have super priority over all other debt, the loan can effectively serve as a risk-free deposit on the assets, thus facilitating what might otherwise be an impossible sale.

Serving as the DIP lender may also be advantageous to a prospective buyer because as lender it has the ability to include covenants in the credit agreement that require the debtor to implement a sale process and take other actions within specified time milestones. The DIP lender/buyer can also negotiate for consent rights over the marketing process, and significant access to information and budgetary controls.

Alicante
Amsterdam
Baltimore
Beijing
Birmingham
Boston
Brussels
Budapest
Colorado Springs
Denver
Dubai
Dusseldorf
Frankfurt
Hamburg
Hanoi
Ho Chi Minh City
Hong Kong
Houston
Jakarta
Johannesburg
London
Los Angeles
Louisville
Luxembourg
Madrid
Mexico City
Miami
Milan
Minneapolis
Monterrey
Moscow
Munich
New York
Northern Virginia
Paris
Perth
Philadelphia
Rio de Janeiro
Rome
San Francisco
São Paulo
Shanghai
Shanghai FTZ
Silicon Valley
Singapore
Sydney
Tokyo
Ulaanbaatar
Warsaw
Washington, D.C.
Zagreb

Our offices
Associated offices

www.hoganlovells.com

"Hogan Lovells" or the "firm" is an international legal practice that includes Hogan Lovells International LLP, Hogan Lovells US LLP and their affiliated businesses.

The word "partner" is used to describe a partner or member of Hogan Lovells International LLP, Hogan Lovells US LLP or any of their affiliated entities or any employee or consultant with equivalent standing. Certain individuals, who are designated as partners, but who are not members of Hogan Lovells International LLP, do not hold qualifications equivalent to members.

For more information about Hogan Lovells, the partners and their qualifications, see www. hoganlovells.com.

Where case studies are included, results achieved do not guarantee similar outcomes for other clients. Attorney advertising. Images of people may feature current or former lawyers and employees at Hogan Lovells or models not connected with the firm.

© Hogan Lovells 2020. All rights reserved. 12202_C2_0118