

For: Abacus Advisors, Closter, N.J.
From: Parness & Associates, Aberdeen, N.J.

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EXPERT QUESTIONS TODAY'S PUSH FOR FAST-TRACK BANKRUPTCY SALES
—Popular 'Section 363' sales certainly are quick, but may not always yield the best return,
Terrence Corrigan of Abacus Advisors writes in the latest issue of ABF Journal.

CLOSTER, N.J. (2/2/2010)—U.S. bankruptcy practices have entered a new paradigm with the widespread embrace of so-called “Section 363” sales—greatly sped up transactions in which assets sell free of liens and other claims, and with a hearing rather than a full vote by creditors. But when banks and lenders place too much emphasis on these sales out of an irrational “need for speed,” they risk losing sight of the ultimate goal of any bankruptcy proceeding: maximizing returns, writes Terrence Corrigan, managing director of Abacus Advisors, in the January/February issue of *ABF Journal*, a leading publication for commercial finance professionals.

In a piece titled “Not so fast: Do quick-and-easy ‘Section 363’ sales always yield the best return on collateral?”, Corrigan acknowledges the role these sales have played in the recent bankruptcies of a litany of cash-strapped businesses, including Lehman Brothers, the Chicago Cubs, Filene’s Basement, Velocity Express, GM, Chrysler and Midway Games. But Corrigan, who has been involved in bankruptcy and creditors’ rights matters for more than 25 years as an attorney, consultant and lecturer, also points to some of the rarely discussed downsides of this fast-track approach to bankruptcy sales.

“Once invoked in only a discrete minority of cases, these expedited sales are fast becoming the preferred way of monetizing assets,” he notes. “Because legal fees and other costs can stack up during a lengthy Chapter 11 reorganization, some asset-based lenders might welcome this trend, reasoning that quicker sales ultimately will translate into maximum return on collateral. In reality, however, Section 363 is anything but a one-size-fits-all solution.”

In a traditional Chapter 11 reorganization, for example, debtors enjoy protections that prevent competitors from stepping in and filing alternative plans. The process does tend to be slow, but with a few exceptions it is quite difficult to upset the plan once it is underway. “Section 363, by contrast, is far less tidy,” Corrigan writes. “As debtors race to secure a bid, they might well offer their favorite suitor a few too many bid concessions like generous expense reimbursements or breakup fees or structural requirements. This can expose the process to charges of being rigged in the bidder’s favor. If the court buys these arguments, it is back to square one for all parties involved.” As an example, Corrigan cites the fits-and-starts sale of Polaroid: the process took five months after the court set aside the auction results twice.

Parties’ lingering concerns also are easier to address in a traditional Chapter 11 plan, he maintains. “If you are a pre-petition lender in a Section 363 sale, it is true that the proceeds are available to you once the assets are sold, but certain issues might come back to haunt the deal, such as whether the lender was partly to blame for the demise of the company,” Corrigan writes. “Lawsuits could be filed with a view toward subordinating or disallowing all or a portion of the secured lender’s claim.”

Nor are all Section 363 sales created equal. Buyers, for example, vary in their level of eagerness to participate in auctions and their preparedness to close a deal, Corrigan observes. “For some buyers, Section 363 sales move too fast and they are unable to submit their highest bid on the court-ordered timetable. For others, they are simply unwilling to participate in an unseemly and widely publicized auction for the debtor’s assets,” he writes. “In both situations, the likely result is less value being realized for the debtor’s assets. Further, a Section 363 bid that is conditioned upon either financing or due diligence makes little sense for creditors, debtors and courts. And yet, some would-be buyers do indeed

submit bids despite having plans to spend, say, 30 more days working on the bank loan, or 60 more days finishing up their due diligence.”

In the piece, Corrigan also points to one of the primary drivers of the Section 363 trend—the extreme caution that has come to dominate lending amid the global credit crisis. He notes that banks have grown reluctant to make debtor-in-possession (DIP) loans, even though these have historically ranked among the safest possible investments. DIP loans enable distressed retailers to, say, continue operating through the holidays and thereby liquidate more merchandise, or allow manufacturers to pay the rent, make payroll and keep the lights on as they reorganize.

“It is a bad time to be a borrower, of course, but it is an even worse time to be a borrower in bankruptcy,” Corrigan writes. “If you are a Filene’s Basement or a Chrysler and you cannot obtain DIP financing, handing the keys to the bankruptcy judge is not an option. You do have to liquidate those assets somehow, and so you are all but forced to hold a fire sale.”

Thus, in many instances, banks are essentially forcing the quick-and-easy route. While it is perhaps understandable that many banks are skittish about financing drawn-out Chapter 11 reorganizations, they ought to think twice about their conservative approach to lower-risk DIP loans, Corrigan argues.

“In the long run, a larger menu of bankruptcy options is in the best interest of banks, trade creditors and debtors alike,” he writes. “In situations where there is a degree of time-urgency, moreover, a Section 363 sale might not be the only option. Prepackaged bankruptcies, whereby debtors win the binding consent of creditors prior to filing under Chapter 11, or pre-negotiated bankruptcies, whereby most of the major constituencies are in place prior to the filing, offer many of the same advantages as traditional Chapter 11 reorganizations. And yet, they can be just as fast as 363 sales.”

The point, he concludes, is not to push for Section 363 sales in all cases. Rather, Corrigan writes, “maximizing collateral value at the time of sale is the ultimate imperative for secured lenders. They should never allow that strategic goal to be eclipsed by an irrational ‘need for speed.’ ”

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About Abacus Advisors

Abacus Advisors (www.abacusadvisors.com) is one of the most experienced turnaround and restructuring firms in the United States. The Closter, N.J.-based firm assists companies of all sizes with comprehensive operational turnarounds, Chapter 11 reorganizations, business wind-downs, real estate dispositions, and out-of-court restructurings. Founded in 1999, the firm also has offices in metro Chicago and Boca Raton.

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