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presents

Bankruptcy Asset Sales: Emerging Legal Strategies

Best Practices for Debtors and Creditors in Section 363, 1123 and 1129 Sales

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:

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Tuesday, June 8, 2010

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Part I
Developing Trends in Bankruptcy Asset Sales

In December 2007, Fed. R. Bank. P. 4001(c) was amended requiring that DIP financing agreements include a number of features such as interest rate, maturity, events of default…etc.

Then There Was the Recession

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There was a shrinkage in DIP Financing Market because many of the traditional DIP Lenders such as Lehman, Merrill Lynch, GE and Wachovia are no longer offering DIP Lending on customary terms

Likewise the cost of borrowing has increased considerably

The Covenant Light Loans Aren’t so Light in Covenants Anymore

The Terms Which Used to Be 12 to 18 months are now 2 to 6 months

With reduced time to negotiate a proper restructuring and increased pressure resulting from fewer lenders, added costs and covenants, Section 363 sales have trended upward

In fact, many 363 purchasers are providing DIP financing as a "bridge" to the 363 sale

So What Does This Mean?

Debtors Must Consider Bankruptcy Earlier in the Process; must build reserves…which often leads to the need to unload assets.

With a belief of a continuing bleak financial picture, third party investors, lenders, hedge funds have sought to capitalize by adopting a "loan to own" strategy where debt is acquired with the purpose of controlling the equity

The negotiations typically occur before the bankruptcy is filed

Who are these “loan to own” lenders?

Prior to 2009 these so called lenders were primarily financial where a private equity fund would set up an investment vehicle to buy the assets

Since the recession the statistics have changed. Only 38% of the acquisitions are with financial investors. 62% are with strategic investors that operate in the same or similar industries

86% of the buyers are buying platform

which is buying a company in a new line of business rather than acquiring a company to merge with a company the buyer owns

11 U.S.C. § 363(k)

At a sale under subsection (b) of this section 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.

Case Study: GM & Chrysler

Bankruptcy Asset Sales: The Changing Landscape; Emerging Legal Strategies for Debtors and Creditors in Sales Under Section 363, 1123, and 1129

Doug Mintz
Cadwalader, Wickersham & Taft LLP
June 8, 2010

Auto Companies In Trouble

- **In the fall of 2008, Chrysler and GM faced severe liquidity shortages triggered by rising gas prices, falling consumer demand and the global recession.**
- **In response, the automakers approached Washington for a bailout.**
- **In December of 2008, the Bush administration agreed to provide $17.4 billion in loans to GM and Chrysler in order to keep the automakers afloat long enough for the Obama administration to determine the best course of action going forward.**
- **In early 2009, GM and Chrysler approached Washington for additional assistance, which was granted and conditioned upon each company submitting a proposal setting forth their plans to effectuate a viable out-of-court restructuring.**
- **GM and Chrysler each submitted multiple proposed restructuring plans to the government. In March of 2009, President Obama rejected those restructuring plans and stated that the government would provide additional funds only if the companies were able to effect a complete reorganization in a shortened time period. The President stated that this likely would occur through the bankruptcy process.**

Determining And Implementing A Plan

- **In early 2009, Treasury and the automakers each focused on a plan to sell the core assets of the companies through a very quick sale in bankruptcy pursuant to section 363 of the Bankruptcy Code.**
- **In each case, all of the “good” assets would be sold to new companies, while all of the “bad” assets (in addition to the sale proceeds) would be left with the estate.**
- **Treasury agreed to provide debtor-in-possession financing to allow the companies to operate while in bankruptcy. Treasury (with some assistance from Canada) provided $33.3 billion in TARP funds to GM and $4.9 billion to Chrysler.**

Determining And Implementing A Plan
(cont'd)

- **In Chrysler's case, Treasury agreed to lend money to New Chrysler, a newly-created entity to be owned by Fiat, the UAW, Treasury, and Canada, which would bid this cash in exchange for Chrysler's assets.**
- **Old Chrysler would then distribute this cash to its senior lenders for payment.**
- **In GM's case, Treasury created New GM, an entity to be owned by Treasury, the UAW and Canada, and contributed to New GM Treasury and Canada's claims with respect to their prepetition and DIP loans.**
- **New GM would "credit bid" those claims in exchange for the core assets of Old GM.**

Achieving Success

- After negotiating the respective sales, Chrysler and GM needed bankruptcy court approval.
- In Chrysler, the dissenting lenders aggressively litigated, arguing that the proposed sale subverted the Bankruptcy Code and the “absolute priority rule” by giving equity in New Chrysler to pre-bankruptcy unsecured creditors (such as the UAW) and assuming the contracts of certain vendors while giving secured lenders a recovery of less than 100 percent.
- The debtors and other parties argued successfully that the buyer could distribute its equity to whomever it wished and that assumption of contracts is standard in bankruptcy.

Achieving Success (cont'd)

- In GM, certain tort litigants and other parties argued that the sale could not be made free and clear of certain future liabilities, including accident and asbestos claimants.
- The debtors and other parties argued successfully that a sale of assets under section 363 of the Bankruptcy Code is free of future liabilities.
- Within 42 days of filing for bankruptcy, Chrysler's sale closed. GM's sale closed 41 days after the petition date.

Bankruptcy Court Opinion – Chrysler

- **The Bankruptcy Court approved the Chrysler sale and clarified the law regarding section 363 asset sales in bankruptcy.**
  - **<u>No *Sub Rosa* Plan</u>. The Court found that "the sale of assets is not a *sub rosa* plan of reorganization. The Debtors are receiving fair value for the assets being sold. Not one penny of value of the Debtors' assets is going to anyone other than the First-Lien Lenders."**
  - **<u>Sale Free and Clear</u>. The Court also addressed the issue of selling free and clear of prepetition obligations and ruled that New Chrysler could buy free and clear from tort claims, as well as any potential state law successor or transferee liability claims.**
  - **<u>Updated Law</u>. The approval of the sale was generally consistent with prior applicable law.**
- **On appeal, the Second Circuit upheld the Bankruptcy Court's decision.**
- **In December 2009, the Supreme Court vacated the judgment below, and remanded the case to the Second Circuit with instructions to dismiss the appeal as moot.**
- **In January 2010, the Second Circuit dismissed the appeal as moot.**

Bankruptcy Court Opinion – GM

- **The Bankruptcy Court approved the GM sale, citing extensively to the Bankruptcy Court and Second Circuit's ruling in favor of the Chrysler sale, noting that the GM case was substantially similar.**
  - **<u>No *Sub Rosa* Plan</u>. The Court confirmed that "it is now well established that a chapter 11 debtor may sell all or substantially all its assets pursuant to section 363(b) prior to confirmation of a plan, when the court finds a good business reason for doing so. . . .[the sale] does not dictate the terms of a plan of reorganization, as it does not attempt to dictate or restructure the rights of creditors of this estate. It merely brings in value. . . . A transaction contemplating that does not amount to a *sub rosa* plan."**
  - **<u>Sale Free and Clear</u>. The Court recognized that "the law in this Circuit and District is clear; the Court will permit GM's assets to pass to the purchaser free and clear of successor liability claims . . ."**
  - **<u>No Debt Recharacterization</u>. The court analyzed the government's prepetition and DIP loans and found that they constituted debt that could be used to credit bid for GM's assets.**
- **This matter is on appeal.**

Part II
RECENT CASES

In re Fontainebleau

In re Pacific Lumber

In re Fontainebleau

- *In re Fontainebleau Las Vegas Holdings, LLC*, No. 09-2148-BKC-AJC (Bankr. S.D. Fla. Dec. 7, 2009)

- Section 363(k) of the Bankruptcy Code gives the court the discretion to deny credit bidding.

In re Fontainebleau

The court concluded that allowing the secured creditors to credit bid at the § 363 sale of an unfinished hotel and casino would—

-- delay the sale

-- deny all creditors the potential benefits of the sale process and

-- continue the erosion of value of the property.

In re Fontainebleau

The court noted:

> *"Even if the lien claims could be adjudicated as to validity, priority and amount, prior to the § 363 sale scheduled for January 21, 2010, there is no feasible procedure to permit five (5) different groups, plus additional unrepresented lien claimants and the dozens of bank mortgage lenders to bid as single bidders against prospective cash bidders."*

In re Pacific Lumber

- *Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).
- Confirmed a plan that cashed out a secured lender at the collateral's court- determined value, without permitting the secured lender to credit bid at the sale of its collateral.

In re Pacific Lumber

- Scopac was subsidiary of Palco and had timber

- Scopac had first lien bank debt of $36 million and second lien notes of $740 million

In re Pacific Lumber

- Secured Creditor had lien on Palco assets for $160 million with value of $110 million
- Plan said Palco’s assets other than sawmill would be transferred to Townco and sawmill and timber would be transferred to Newco.
- Stock for debt to Secured Creditor of the $160 million for all of stock of Townco and 15% of Newco
- Secured Creditor contributed $580 million to Newco to pay Scopac claims

In re Pacific Lumber

- Noteholders got paid the value of their collateral in cash plus proceeds of certain litigation. Deficiency claim was unsecured
- Noteholders said they should be allowed to credit bid

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In re Pacific Lumber

- Court said transaction was a sale but would not let Noteholders credit bid since claim was to be paid in cash which is the indubitable equivalent.
- Court guessed on the value of the Noteholders' claims
- Noteholders argued 203 LaSalle requires an auction where they could credit bid.

In re Pacific Lumber

- Ruled that the cash payment to the secured lender was the indubitable equivalent of the secured lender's claim.

- How can it be the indubitable equivalent if the court had to guess the value?

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More Legal Developments in Asset Sales

Felicia Perlman

Legal Developments in Asset Sales

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- Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*
- Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*
- Expanded Protection of Sale Orders – *In re Westpoint Stevens, Inc.*

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- Background of *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010)
  - Affiliate debtors, who owned and operated the *Philadelphia Inquirer* and *Philadelphia Daily News*, filed for chapter 11 protection after defaulting on debt in excess of $300 million secured by first priority liens in substantially all of the debtors' real and personal property
  - The plan of reorganization provided for the sale of substantially all of the debtors' assets pursuant to section 1123 of the Bankruptcy Code at a court-approved auction
  - The bidding procedures sought to preclude secured creditors from credit bidding pursuant to section 363(k) of the Bankruptcy Code by requiring that all bids be in cash

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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(continued)

- Under the plan, the secured lenders would receive approximately $37 million in cash proceeds from sale of collateral proposed by the plan
- If the assets were sold pursuant to a higher bid, the secured lenders would receive any additional cash generated by the sale
- In addition, the lenders would receive the debtors' headquarters building, valued at $29.5 million, subject to a two year rent-free lease to the stalking horse

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- Proceedings Prior to Third Circuit Decision
  - Secured lenders objected to the prohibition against their credit bidding – the bankruptcy court sustained the secured lenders' objection and required that the secured lenders be allowed to credit bid
  - On appeal, the District Court for the Eastern District of Pennsylvania, reasoning that the plain language of section 1129(b)(2)(A) of the Bankruptcy Code provides no legal entitlement for secured lenders to credit bid an auction sale of their collateral conducted under a plan of reorganization

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- Third Circuit Court of Appeals affirmed the district court's ruling, holding that section 1129(b)(2)(A)(iii) of the Bankruptcy Code permits a sale of secured lender collateral free of lender liens, without providing credit bidding rights to the lender when their collateral is sold under a plan of reorganization
- Like the district court, the Third Circuit applied a plain-meaning analysis to section 1129(b)(2)(A), observing that each of the three subsections can be applied in the alternative to satisfy the "fair and equitable" requirement
  - Section 1129(b)(2)(A) provides for cramdown of secured creditors if the plan provides for (i) retention of liens with deferred cash payments, (ii) sale of collateral subject to the right to credit bid under section 363(k), *or* (iii) realization of the indubitable equivalent
  - The Third Circuit focused on the use of the disjunctive "or" in section 1129(b)(2)(A)

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- The court further reasoned that a plan that provides secured creditors with the indubitable equivalent need not provide secured creditors with the opportunity to credit bid
  - The court rejected the secured lenders argument that "indubitable equivalent" is ambiguously broad
    - Explained that "a statue is not ambiguous merely because it is broad in scope"
    - Also observed that the indubitable-equivalent prong remains subject to the same principles of fairness as the other two prongs of section 1129(b)(2)(A)
  - Unlike the sale prong of 1129(b)(2)(A), the indubitable-equivalent prong contains no explicit right to credit bid

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

Skadden

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- The court noted that its ruling was not inconsistent with *In re SubMicron Systems Corp.*, 432 F.3d 448 (3d Cir. 2006), which held that secured creditors were entitled to credit bid up to the full amount of their collateral in a sale under section 363(b)
  - Court explained that its holding in *SubMicron* was that the credit bid set the value of a creditor's secured interest in the collateral
  - When examining whether a secured creditor has received the indubitable equivalent, the bankruptcy court must determine whether the secured creditor received the indubitable equivalent of its collateral
    - The value to secured creditors can take different forms, including cash proceeds from sale, substitute collateral, or real property
    - Value achieved by secured creditors is not limited to the sale price at an auction; rather, "it is the plan of reorganization, and not the auction itself, that must generate the 'indubitable equivalent'"
- The court declined to determine whether the plan would provide secured lenders with the indubitable equivalent, leaving that issue for confirmation

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- The opinion goes on to reject the argument offered by secured lenders and the bankruptcy court that limiting the ability to credit bid at a sale of collateral would contravene the protections provided to secured creditors under section 1111(b) of the Bankruptcy Code
  - The court reasoned that recourse lenders are not entitled to make an 1111(b) election when collateral is sold under section 363 or a plan of reorganization, and the indubitable-equivalent prong of section 1129(b)(2)(A) provides that collateral may be sold under a plan without giving secured creditors the right to credit bid

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- One member of the three-judge panel filed a dissent, arguing that the better reading of section 1129(b)(2)(A) is that sales under a plan of reorganization must be conducted under the sale-prong, which affords secured creditors the opportunity to credit bid
  - Focused on legislative intent, particularly the legislative history behind section 1111(b)
  - Observed that the statutory scheme – specifically the interplay between sections 1123(a)(5), 363(k), and 1111(b) – is intended to protect secured creditors when their collateral is sold, not debtors or insiders

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- Potential implications of the Third Circuit's ruling in *Philadelphia Newspapers* (and the Fifth Circuit's ruling in *Pacific Lumber*)
  - Increased negotiating leverage of debtors with their secured creditors resulting from debtors' ability to dispose of collateral and raise cash under a plan – without the consent of secured creditors – so long as the plan provides secured creditors with the indubitable equivalent of their secured claim
  - Increased risk to secured lenders may increase borrowing costs
  - Secured lenders may be unwilling to provide debtors with the financing necessary to conduct an asset sale in bankruptcy absent an agreement from the debtor to conduct any sale pursuant to section 363 of the Bankruptcy Code, thereby permitting the secured lenders to credit bid pursuant to section 363(k)

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- Impact of Third Circuit's ruling may be limited because the court refrained from making a determination as to whether the indubitable-equivalent prong was satisfied
  - Whether the proposed plan of reorganization would have satisfied the indubitable-equivalent prong remains an open question
    - Subsequent to the Third Circuit's decision, secured lenders who challenged the plan ultimately submitted the winning $139 million bid at auction, so bankruptcy court will not have to make a determination as to the indubitable equivalent
    - Cases generally have found that secured creditors receive the indubitable equivalent of their collateral in two circumstances that were inapplicable:
      - Secured creditors keep their collateral; or
      - Secured creditors receive a payment stream in the amount of their claim secured by a replacement lien in replacement collateral that is at least equal in value to their original collateral

Limiting the Right to Credit Bid – *In re Philadelphia Newspapers, LLC*

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- Compare with *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009), where court held that plan that provided for secured lenders to receive cash in the appraised value of their collateral satisfied the indubitable-equivalent prong
  - In *Pacific Lumber*, the plan of reorganization at issue – which provided for secured lenders to receive the indubitable equivalent of their collateral – had already been confirmed by the bankruptcy court
  - The Fifth Circuit was satisfied that payment of cash in the amount at which the collateral was valued satisfied the indubitable equivalent, reasoning that "[w]hatever uncertainties exist about indubitable equivalent, paying off secured creditors in cash can hardly be improper if the plan accurately reflected the value of the Noteholders' collateral"

Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*

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- Background to *In re Reliant Energy Channelview L.P.*, 594 F.3d 200 (3d. Cir. 2010)
  - Reliant Energy Channelview LP and Reliant Energy Services Channelview LLC (together, the "Debtors") proposed to sell their largest asset, a power plant
  - After a robust marketing process in which the Debtors contacted over 100 potential purchasers, 38 potential bidders signed confidentiality agreements, 24 entities conducted due diligence, and 12 entities submitted bids (most of which were contingent on financing)
  - Kelson Channelview LLC ("Kelson") submitted a $468 million bid that was not contingent on financing
  - The Debtors selected Kelson's bid as the winning bid and entered into an APA with Kelson

Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*

Skadden

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- The APA provided that the Debtors would immediately seek Bankruptcy Court approval of the sale (i.e., the Debtors were going to seek to forego an auction)
- The Debtors agreed that they would seek certain bid protections for Kelson if the Bankruptcy Court determined that an auction was necessary
  - Section 8.1 of the APA stated that "[The Debtors] shall . . . file a bidding procedures motion with the Bankruptcy Court . . . seeking the entry of an order approving the bid protections"
  - The bid protections included a $5 million minimum overbid, a $15 million break-up fee (roughly 3% of Kelson's bid) and a reimbursement for Kelson's expenses (up to $2 million)

Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*

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- Ultimately, the Bankruptcy Court refused to approve the sale of the plant to Kelson without an auction
- The Bankruptcy Court entered an order approving both the $5 million minimum overbid requirement and the reimbursement for Kelson's expenses
- The Bankruptcy Court rejected, however, the break-up fee
- As a result of the Bankruptcy Court's refusal to approve the break-up fee, Kelson refused to participate in the auction
- The eventual winning bid (fully-financed) exceeded Kelson's bid by $32 million
- Following the entry of the sale order, Kelson appealed the Bankruptcy Court's order denying the payment of the break-up fee
- The District Court affirmed the Bankruptcy Court's order, thus denying the break-up fee

Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*

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- The United States Court of Appeals for the Third Circuit considered Kelson's appeal within the context of the "*O'Brien* standard." *See Calpine Corp. v. O'Brien Env't Energy* (*In re O'Brien Env't Energy, Inc.*), 181 F.3d 527 (3d Cir. 1999)
  - The *O'Brien* court held that a bidder must seek a break-up fee as a post-petition administrative expense under 11 U.S.C. § 503(b)
  - The requesting bidder would have to show that the fees were "actually necessary to preserve the value of the estate"
  - The O'Brien court also stated that a break-up fee is not necessary to preserve the value of the estate if the bidder would have bid without it

Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*

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- In applying *O'Brien* to the case at hand, the Third Circuit asked two questions:
  (1) Was the break-up fee necessary to induce Kelson to bid; and
  (2) Was the break-up fee necessary to induce Kelson to adhere to its bid
- The Court answered the first question in the negative
  – Based on the language in the APA, the Court found that Kelson did not condition its bid on the presence of a break-up fee, but rather on the Debtors' promise to *seek* a break-up fee if an auction was necessary
  – The Court thus held that "Kelson *did* make its bid without the assurance of a break-up fee, and this fact destroys Kelson's argument that the fee was needed to induce it to bid." *In re Reliant*, 594 F.3d at 207 (emphasis in original)

Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*

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- The Court also found that the break-up fee was not needed to preserve Kelson's bid
- The Court determined that the Bankruptcy Court justifiably determined that the break-up fee was not necessary for the protection of the estate for three reasons:
  (1) Another entity asserted that it planned to bid;
  (2) The language of the APA bound Kelson to its bid; and
  (3) The logical belief that Kelson would not abandon a fully negotiated agreement in the absence of other bidders
- In sum, the Court concluded that the Bankruptcy Court did not abuse its discretion when it entered an order denying authorization to pay the break-up fee

Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*

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- Takeaways from the decision:
  - Stalking horse bidders should ensure that the deal documents explicitly state that the bid is conditioned on bankruptcy court approval of the break-up fee (i.e., that the stalking-horse bidder has the right to terminate its offer if the bankruptcy court fails to approve the break-up fee)
  - If other bidders are present, a stalking horse bidder should prepare for the possibility that no break-up fee will be approved (the Third Circuit endorsed the Bankruptcy Court's pronouncement that break-up fees often are not needed when there are bidders for an asset other than the initial bidder)

Allowance of Break-Up Fees – *In re Reliant Energy Channelview L.P.*

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- It should be noted that the Third Circuit is somewhat atypical with respect to the approval of break-up fees
- Courts outside the Third Circuit apply a less rigorous standard when considering break-up fees
  - *See, e.g., Wintz v. American Freightways Inc., et al.* (*In re* Wintz Co.), 230 B.R. 840, 846 (B.A.P. 8th Cir. 1999), *aff'd* 219 F.3d 807 (2000)*Official Comm. Of Subordinated Bondholders v. Integrated Res. Inc.* (*In re* Integrated Res. Inc.), 147 B.R. 650, 657 (S.D.N.Y. 1992);; *In re America West Airlines, Inc.*, 166 B.R. 908, 912 (Bankr. D. Ariz. 1994)
- Therefore, stalking horse bidders may be in a more favorable position vis-à-vis break-up fees in courts outside the Third Circuit

Expanded Protection of Sale Orders – *In re Westpoint Stevens, Inc.*

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- Background of *In re Westpoint Stevens, Inc.*, 600 F.3d 231 (2d Cir. 2010)
  - Two competing groups of secured lenders sought to purchase assets from the debtor
    - First-lien bidding group controlled the majority of the $488 million first-lien secured claims
    - Second-lien bidding group controlled 51% of $166 million second-lien secured claims and 40% of the first-lien secured claims
  - Ultimately, the second-lien bidding group prevailed over first-lien bidding group's credit bid on a bid that provided for:
    - 82.5% of equity to be distributed to first and second lien lenders
      - First-lien lenders receive the first $488 million in equity, remainder to second-lien lenders
    - 17.5% of equity in acquiring entity purchased by the second-lien bidding group for $187 million cash
    - Net result was that second-lien bidding group would receive at least 50.5% of the equity in the acquiring entity

Expanded Protection of Sale Orders – *In re Westpoint Stevens, Inc.*

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- The sale closed, but first-lien lenders continued to pursue their appeal
  - The first-lien bidding group originally sought to stay the sale while pursuing an appeal of the sale order, but the first and second lien bidding groups later entered into a stipulation providing that the second-lien bidding group's equity in the acquiring entity would be held in escrow until the first-lien bidding group's appeal was resolved
  - On appeal, the district court ruled that the first-lien bidding group's arguments regarding the distribution of equity directly to first-lien lenders was statutorily moot under section 363(m), but remanded the case on other issues
    - The district court agreed with the first-lien lenders arguments that there was no contractual basis for allowing distributions to second-lien lenders and that there was no statutory basis for discharging the first-lien lenders' claims and releasing their liens

Expanded Protection of Sale Orders – *In re Westpoint Stevens, Inc.*

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- On remand, the bankruptcy court issued two orders
  - The first order authorized the satisfaction of first-lien lenders' claims on account of the distribution of equity provided for in the second-lien bidding group's bid
  - The second order released adequate protection payments to the second-lien lenders
- The district court reversed the bankruptcy court's order regarding the satisfaction of first-lien lenders' claims but affirmed the adequate protections payments to second-lien lenders
- Both the first- and second-lien bidding groups appealed to the Second Circuit Court of Appeals
  - The second-lien bidding group appealed the district court's reversal on the issue of satisfaction of first-lien lenders' claims
  - The first-lien bidding group cross-appealed the order of the district court affirming adequate-protection payments to second-lien lenders

Expanded Protection of Sale Orders – *In re Westpoint Stevens, Inc.*

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- Second Circuit held that, under section 363(m) of the Bankruptcy Code, appellate review of 363 sale orders generally is limited to determining whether a sale was in "good faith" unless the sale has been stayed pending appeal
  - The Second Circuit adopted a broad reading of statutory mootness, concluding that "under section 363(m), we lack jurisdiction to review the entire Sale Order—not just the actual sale transaction"
  - The court identified limited exceptions to its broad reading of statutory mootness
    - Courts retain jurisdiction to review challenges to the "good faith" component of a 363 sale
      - The parties' good faith was not an issue before the Second Circuit
    - In addition, "[a] narrow exception may lie for challenges to the Sale Order that are so divorced from the overall transaction that the challenged provision would have affected none of the considerations on which the purchaser relied"
      - The court found that the challenged aspects of the Sale Order were essential to the second-lien bidding group's bid

Expanded Protection of Sale Orders – *In re Westpoint Stevens, Inc.*

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(continued)

- The court reasoned that its broad reading of statutory mootness was appropriate in light of "the uniquely important interest in assuring the finality of a sale" conducted pursuant to section 363 of the Bankruptcy Code

- After determining that challenges to the Sale Order were subject to section 363(m), the Second Circuit's analysis turned to distribution of the escrowed securities, which was subject to a stay pursuant to the stipulation entered into by the parties
  - Court recognized that the first-lien lenders were entitled to be paid in cash, but forfeited that right by withdrawing their appeal on those grounds
  - Second Circuit used equitable powers to fashion a remedy that gave first-lien lenders that were not part of the second-lien bidding group an additional 11% equity interest in the acquisition entity while still preserving the second-lien bidding group's controlling interest in the acquiring entity

Expanded Protection of Sale Orders – *In re Westpoint Stevens, Inc.*

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- Impact of *Westpoint Stevens*
  - The Second Circuit's decision provides parties to sales under section 363 of the Bankruptcy Code additional certainty that there agreement will not be disturbed after the sale is consummated
    - *Cf.* Clear Channel Outdoor, Inc. v. Knupfer (*In re* PW, LLC), 391 B.R. 25, 35-36 (9th Cir. B.A.P. 2008) (concluding that "§ 363(m) does not apply to lien-stripping under § 363(f)")
  - Emphasizes the importance of seeking a stay for parties challenging a 363 sale