THE BANKRUPTCY STRATEGIST

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A Tale of Two Asset Sales

When 'Highest' Isn't Necessarily 'Best'

The bankruptcy process is intended to maximize value inuring to the stakeholders of a troubled company — a goal casually referred to as obtaining the "highest and best" value from the process. Restructuring professionals seek well-worn paths to achieve the highest and best value for a troubled company's assets, whether pursuing, settling or assigning claims or causes of action; unlocking hidden value in tax attributes; or running robust sale processes. Often, parties equate "highest" with "best," which leads to sales processes with foregone conclusions and we never know what opportunities were left on the table that could have increased value for stakeholders. What follows is an example in which a Chapter 7 trustee, in deliberately separating the measure of "highest price" from "best outcome," unlocked significant value for all stakeholders.

History

Formed in 1965, North American Specialty Glass (the Debtor) became one of the largest safety and security glass producers in the United States. By 2012, it employed nearly 100 people, a significant percentage of the working population in its home of Trumbauersville, PA. After several covenant defaults, the company was put into workout by Sovereign Bank, its secured lender, in 2009. During the lengthy forbearance, the Debtor's equity sponsor, Ironwood Mezzanine Fund and its affiliate (Ironwood), provided capital infusions to support the company's continued operation.

In March 2012, Ironwood ceased providing capital to the company and Sovereign indicated that the Debtor would need to provide an exit to the Sovereign loan. A sale process commenced, with Ironwood introducing two potential purchasers, one of which was a competitor (the Competitor) of the Debtor, who ultimately submitted a purchase bid; Sovereign shopped the opportunity to several prospective purchasers as well. Grey Mountain Partners (Grey Mountain) also indicated interest on its own and submitted a bid that was significantly lower than the bid submitted by the Competitor. As September 2012 began, there were two parties bidding for the company — the Competitor and Grey Mountain.

Because of the higher cash price offered, the company entered an exclusivity agreement with the Competitor for purchase of the Debtor. The transaction was subsequently changed to a sale of assets under Article 9 of the Uniform Commercial Code (UCC) with a completion deadline of Sept. 28, 2012. This change was accompanied by a significant reduction in sale consideration to an amount less than Grey Mountain had offered. As the Debtor faced a mounting liquidity crisis, Sovereign ceased funding the Debtor. To preserve the value of the company's assets, the company's management shut down the company on Sept. 26, 2012, and filed a defensive Chapter 7 bankruptcy petition on Sept. 27, 2012.

Chapter 7

Robert Holber, the Chapter 7 trustee appointed to administer the Debtor's assets, quickly determined the universe of potential purchasers, including Grey Mountain, the Competitor, and the Debtor's landlord (who happened to be a former owner of the Debtor). Given the Debtor's liquidity requirements and urgent need to restart operations to preserve the viability of the company's business, the Grey Mountain bid was determined to be the only workable scenario. The Grey Mountain bid provided for $1.5 million in cash consideration; assumption of certain liabilities; the continued employment of at least 90% of the Debtor's workforce; and payment to unsecured creditors by the purchaser of several hundred thousand dollars. The Trustee sought an expedited sale process to allow the transaction to occur and the Debtor's operations to be restored quickly, with an auction contemplated to occur within a week of the Trustee's motion to approve the sale. The Debtor's competitor also bid for the company, with a cash purchase price that was higher than Grey Mountain's bid.

Ultimately, a number of factors led the Trustee to accept Grey Mountain's bid as the better one, despite the fact that the Competitor offered more cash on the barrel. First, the Grey Mountain bid had the support of the workforce, whose jobs would be restored. The societal impact of nearly 100 jobs in a small community could not be ignored. Second, Ironwood partners, the junior secured creditor, agreed to waive its liens against the Debtor, which freed up more than $10 million in value for the estate after Sovereign was paid that would have been otherwise unavailable. By continuing employment, the company eliminated the possibility of employee claims amounting to

60 days of wages as provided for under the WARN Act. The Debtor’s largest unsecured creditor also weighed in with its support of the Grey Mountain bid. Unsecured creditors would receive value under the Grey Mountain bid that would not otherwise find its way to that class of creditors.

'Highest' v. 'Best'

Recognizing the fundamental differences between the bids and agreeing with the Trustee’s rationale for accepting the Grey Mountain bid, the bankruptcy court went to great lengths to differentiate from and distinguish between the "highest" versus the "best" bid. In each case in the sale order, the court changed the language such that the order no longer recognized the winning bid as the highest bid, but rather as the proper exercise of the Trustee’s business judgment. Had the winning bid been that with the highest cash purchase consideration, the outcome might have been very different. First, the excess cash would have been consumed by the liens of the first and second-lien creditors. Second, the loss of jobs would have created additional claims against the company likely surpassing even the claims of trade creditors. Finally, while not strictly the purview of the bankruptcy estate, the employment prospects for the town would have been decimated.

Another Scenario

Consider this outcome against a more traditional "highest equals best" sale scenario. Oreck Corporation, manufacturer of premium vacuum cleaners and consumer products, filed a Chapter 11 petition on May 6, 2013, in the Middle District of Tennessee. Shortly thereafter, the Debtors filed a motion to sell substantially all of the Debtors assets to Oreck Acquisition Holdings LLC (Holdings), an entity formed by an Oreck family member, a former insider of the Debtors. The stalking horse offer provided for $14.5 million in cash, plus another $500,000 in executory contract cure amounts, with setoff remedies for additional cure amounts required; and the assumption of various return and customer liabilities which, in total, provided for total consideration amounting to $21.882 million.

This offer also included what were routine terms and protections for the bidder, including expense reimbursement provisions. After numerous parties, including the United States Trustee and the Official Committee of Unsecured Creditors, filed objections to the terms of the sale and the bidding procedures, the parties negotiated resolutions to these objections. After a hearing, the court approved the modified sale and bid procedures. The modifications included limiting the stalking horse’s expense reimbursement to $1.2 million.

The Debtor’s investment banker, a firm with expertise in consumer products companies, marketed widely to find interested purchasers. The company was marketed as a single entity, with manufacturing and retail locations tied together. Royal Appliance Mfg. Co. (Royal), the maker of Royal and Hoover vacuums and a competitor of the Debtor, submitted a competing bid and the parties went to an auction on July 8, 2013, to find the highest and best bidder. After several rounds of bidding, Royal emerged the winner, offering cash consideration of $17.25 million and other conditions consistent with the stalking horse bid. In short, the Royal bid provided for $2.75 million more in cash before consideration of other terms and conditions.

After the sale was approved, Holdings filed a motion seeking fees and expense reimbursement in the amount of $1.2 million, the cap provided for in the sale procedures order. These fees represented a discount from the asserted actual fees totaling an amount in excess of $1.6 million, mostly for legal counsel for the stalking horse bidder. This request drew limited objections from the United States Trustee and informal objections from other parties, resulting in a reduction of $25,000, to $1.175 million. When considering the impact of this expense reimbursement, the winning bidder’s excess cash consideration is reduced from $2.75 million to $1.575 million.

Shortly after the closing of the sale in September 2013, Royal entered into an agreement with Holdings to sell the Oreck company retail stores to the latter for an undisclosed amount. In the end, Oreck was sold — Royal got the brands that it wanted and the manufacturing facility it could use while getting rid of the stores it never wanted; Holdings got the stores it wanted without manufacturing facilities it didn’t want. The estate got a diminishing pot of money which, after paying off the secured lender and dealing with purchase cost adjustments, wasn’t necessarily better in the end — it was just higher in the beginning.

A Sale Gone Wrong?

Is *Oreck* an example of a sale gone wrong? Hardly. Rapid asset sales of companies in decline are commonplace. Measured by the dollars into the estate when compared between the two offers that were on the table, the offer providing for the highest cash consideration won — the "highest" bid won. It’s easy to say that the "highest" bid, in this instance, was also the best bid on the table, as well. Could it have been done any differently?

Perhaps, with the benefit of hindsight, the lots could have been split such that Royal could have purchased from the estate the brands and manufacturing and Holdings could have purchased from the estate the retail stores — but without competitors for each of those lots, there would be no reason for the parties to bid in amounts that aggregated to more than the winning bid in this case.

Conclusion

In Oreck, the highest and best bid won, but the story is certainly more routine than that of North American Specialty Glass. Why? Competition is one reason. Had there been no competition in North American, the parties that aligned behind the Grey Mountain bid might not have felt compelled to do so. Perhaps there would have been no waiving of the junior lender's liens. Perhaps the economic and societal outcomes would have been less inspiring.

The lesson of North American Specialty Glass as differentiated from, for example, an Oreck, is this: There are limited instances in which an opportunity presents itself to be able to cast aside traditional wisdom that higher equals better in favor of a lower cash bid, but with a better outcome for the stakeholders. The key is to be aggressive about finding ways to recognize that outcome when it can be done, and to be able to quantify intangible benefits that insure to stakeholders beyond simple cash consideration.

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