



Buying Assets From a Troubled Company

While the economic downturn has affected many companies negatively, opportunities will present themselves to companies that remain strong. One opportunity is to acquire assets from companies that are not able to maintain their businesses, either because they have lost customers or because they are not able to get financing. The question is how to benefit from those opportunities without taking on unnecessary risks.

The traditional method for purchasing a business is through an asset sale, stock sale or merger or reorganization. In good times, the decision of what structure to use for the purchase of a business is largely dictated by tax and operational considerations. Liability issues are generally addressed through contractual representations, warranties and indemnification.

The problem with all of traditional methods of acquiring a business is that the buyer either actually or potentially assumes the seller's liabilities. In the case of a stock sale or merger, there is no way to avoid the assumption of the seller's liabilities since the stock sale or merger has the effect of transferring all of the assets and liabilities of the seller to the buyer. In the case of an asset sale, courts have determined, even if the asset purchase agreement specifically provides that the assets of the seller will not be assumed by the buyer, that if the buyer is continuing the seller's business, the asset sale may result in a "de facto" merger and thus the buyer will be deemed to have assumed the seller's liabilities.

Much of the energy spent negotiating a traditional purchase agreement is therefore spent on the recourse that the buyer will have against the seller for liabilities of the seller. But in the case of the purchase of a distressed company, that time would be wasted, since after the sale takes place, the distressed company will most likely have no assets and may not even receive any of the proceeds of the sale.

Another problem is that the traditional asset sale or other type of purchase is often not possible because the seller will not be able to satisfy its liabilities out of the sale proceeds, so coordination and negotiation with the distressed company's creditors will be necessary in order to accomplish the sale. In a traditional sale, the liens placed on the company's assets will follow the sale. Accordingly, if the debts cannot be satisfied, the assets will still be encumbered by those liens.

One method of acquiring a troubled company is through a bankruptcy proceeding. This type of transaction is generally called a "prepackaged Chapter 11" or a "363 Sale", meaning that before the bankruptcy filing is made, a buyer has already been secured to buy the assets of the troubled company, free and clear of any liens, pursuant to Section 363(m) of the United States Bankruptcy Code. This is generally considered the best method of ensuring that the buyer does not unintentionally take on the troubled company's problems, since the troubled company will be able to transfer its assets to the buyer free of the troubled company's debts.

[An alternative method to a prepackaged Chapter 11 is a public or private sale from the troubled company's secured creditor.]

The problem with this method is that it is expensive and takes time. Also, the court will generally hold an auction or other proceeding to confirm that the buyer's offer is, in fact, the "highest and best offer". If the buyer is not the successful bidder, the expense of negotiating a contract and attending the bankruptcy hearings may be for naught, since the buyer may walk away without the assets it wished to purchase. The buyer can negotiate a "break-up fee" to protect itself from the expense of being the party to pave the way for other bidders and then losing the bidding. However, break-up fees are not always enforced by the bankruptcy court, and when enforced are only enforced to the extent that they are considered to be reasonable.

Finally, in order to maintain the troubled company's business during the bankruptcy proceeding, companies used to turn to banks and other financial institutions to provide "debtor-in-possession" financing. This type of financing is no longer readily available.

An alternative method to a prepackaged Chapter 11 is a public or private sale from the troubled company's secured creditor. This is generally called an "Article 9 Sale", because it is a sale by the troubled company's secured creditor pursuant to Article 9 of the Uniform Commercial Code, the law that governs security interests on personal property. This type of transaction generally requires cooperation from the secured creditor and the troubled company, since without cooperation from those

parties, the sale will probably be challenged in court, resulting in delays and expense. Generally the secured party, buyer and debtor coordinate a plan, based on the acceptance by the secured party of an agreed-upon price for the assets from the buyer, and the agreement between the secured party and the debtor that upon the sale of the assets to the buyer, the troubled company's debts will be deemed satisfied.

Depending on the type of assets at stake, the secured creditor may sell the assets of the troubled company to the buyer without even offering them for sale at an auction. That means that, so long as the troubled company cooperates, a sale can take place, on notice to the troubled company and its creditors, within a very short period of time. The effect of the sale is to transfer the assets to the buyer free and clear of any liens, providing the secured party has a first priority lien. The parties must make certain that all notice requirements under Article 9 are satisfied, and that the parties comply with the State of New Jersey's bulk sales laws.

After purchasing the assets free and clear of liens, will the failure to pay any of the troubled company's creditors hurt the acquirer's ability to benefit from the acquisition? For example, is there a landlord who needs to be addressed, or customers whose warranty claims would need to be satisfied? If the answer to any of these questions is "yes", the acquirer should account for these types of additional costs to the purchase in negotiating the purchase price of the assets.

These legal strategies may provide a solution to a company that wants to acquire a troubled company's business when traditional methods would not work. By using them, you may be able to take advantage of an opportunity that otherwise would have been too risky.

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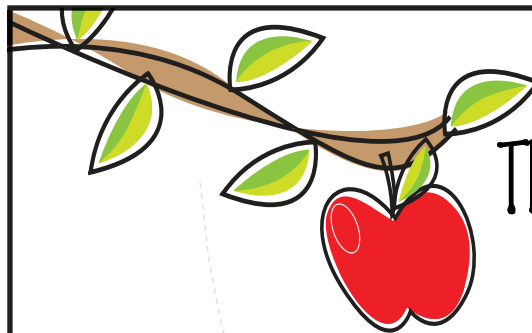
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