Fewer Stalking Horse Perks Discourage Distressed Buyers

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Stalking horse bids are key to a successful sale in a bankruptcy proceeding, but as courts heighten their scrutiny of bidder protections, some potential investors are opting to forgo the advantages of a bankruptcy auction process for the freedom of private sales, experts say.

Sales under Section 363 of the Bankruptcy Code offer obvious advantages to buyers interested in acquiring a bankrupt company's assets, most notably the right to purchase the property free and clear of encumbrances. But with judges leaning toward longer auction processes and placing higher scrutiny on breakup fees imposed on debtors that choose to accept bids other than the stalking horse, distressed investors are nervous about putting too much effort into securing a stalking horse position when they stand a decent chance of being outbid down the road.

"Whenever you have a situation where you have a long, drawn-out bidding procedure, it just increases the uncertainty [for bidders]," Scott Van Meter of the Berkeley Research Groupsaid.

Judges have been pushing long auctions to ensure that the debtor is able to obtain the best offer, Maria DiConza of Greenberg Traurig LLP said. But a lengthy bidding period means the stalking horse bidder runs the risk that another interested buyer could put forward a better offer, and it's costly too, attorneys say.

In a recent example, U.S. Bankruptcy Judge Kevin Gross in Delaware refused to sign off onFisker Automotive Holdings Inc.'s prearranged sale to senior debt holder Hybrid Tech Holdings LLC. Instead, he sided with the committee of unsecured creditors, who had demanded an open sale process that would allow Chinese auto giant

Wanxiang Group Corp. to press an eleventh-hour bid.
Wanxiang **ultimately prevailed** in the bidding battle last month.

To avoid wasting time on a stalking horse bid that eventually fails, some investors are making efforts to acquire distressed companies' assets before the bankruptcy process begins. Private sales keep costs down, provide more leeway for buyers to get what they want, keep the public at bay, and come with less risk that a higher and better offer will appear. Those benefits, for some investors, are proving to be more attractive than controlling an auction through a stalking horse bid, experts said.

The growing interest in private sales coincides with a decline in the number of bankruptcies being filed, Van Meter noted. And as the bankruptcy process **becomes less appealing to distressed investors** due to its high costs, they are turning to methods outside of stalking horse bids to acquire desirable assets.

"There is reluctance to spend time and energy and due diligence to create a stalking horse offer which is really going to be utilized by the market as a benchmark for future bidding," said Daniel Eliades of Forman Holt Eliades & Youngman.

If a buyer does deem a stalking horse bid the best way to go, it's more likely to get a judge to sign off on a shorter auction if it presents a legitimate business justification, DiConza said. For instance, if closing a separate deal related to the sale within a set time frame is an issue, the court may be more open to keeping a tight schedule.

Similarly, if the debtor can prove to the court that it conducted an extensive marketing process before selecting a stalking horse bidder, it has a better shot at a quick auction, DiConza added.

On top of advocating for lengthier bidding processes, judges have been evaluating breakup fees more closely in recent years, creating additional time and expense for buyers. The Third Circuit's 2010 decision in Kelson Channelview LLC v. Reliant Energy Channelview LP, which upped the level of scrutiny on an unsuccessful stalking horse bidder's breakup fee, is partially responsible for this.

But also to blame are the rising figures investors have been demanding for breakup fees and expense reimbursements. In 2012, the average fees were 3.7 percent of the total deal price and the average reimbursements were 2.3 percent, according to Jonathan Young ofEdwards Wildman Palmer LLP.

Investors have been growing particularly concerned over certain practices in bank holding company bankruptcies, Van Meter said. In some instances, when buyers have to assume liabilities and contribute a certain amount of capital to the bankruptcy estate, courts won't allow the breakup fee to be applied to the capital being infused to the estate, which sometimes is the largest part of the deal, he said.

"That's raised some concerns with buyers out there," Van Meter said.

Due to the natural disconnect between a court's interest in ensuring the best offer has been produced and a stalking horse bidder's interest in making its time and effort worthwhile, it's important for a potential buyer contemplating a stalking horse offer to balance the strategic need for expediency with the economic benefits of whatever protections are provided by the court, Young said.

"If the potential bidder wants the assets badly enough, that bidder might consider forgoing stalking horse status and making its best bid on the front end — either with a 'no-shop' contingency, or with a short and hard date for accepting that bid," Young said.

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