31 The Role of the Investment Banker

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31.01 INTRODUCTION

The skills and tactics required in distressed purchase and sale transactions, including but not limited to those consummated in bankruptcy, are markedly more advanced than those involving solvent companies. Frequently occurring problems that must be solved in order to consummate a distressed transaction—in addition to those found in more conventional merger and acquisition (M&A) transactions—include (1) time constraints on the seller due to either ongoing business deterioration or immediate need for the proceeds of a sale and (2) impediments to a swift closing caused by the bankruptcy process and/or the need to obtain transaction approval from multiple constituencies.

Solving these problems, on both the buy-side and the sell-side, requires a team of experienced legal and financial professionals. These professionals, collectively with the client, develop the strategies to be used in the purchase or sale transaction. These strategies are then implemented by the financial professional: the investment banker.

[1] Sell-Side Practices

Transactions involving distressed assets do not always commence in chapter 11, but often are consummated there, either for the protections available thereunder or because circumstances or strategies so dictate. In any event, the strategies for a distressed transaction are generally similar in or out of chapter 11. Irrespective of the venue, in most cases the sale of a troubled business as a "going concern" will produce a higher value than the liquidation of its assets.

Obtaining the highest value should be the goal of any seller, particularly one in bankruptcy with creditor claims to satisfy and shareholder desires for a recovery. However, a seller's going-concern sale value can be dissipated in a number of ways, including:

- *The re-trade.* Because of time pressure and the continued deterioration of the business, a distressed seller is frequently a vulnerable seller, even after entering into a definitive sale agreement. A buyer may take advantage of perceived seller weakness by renegotiating price terms downward on the eve of closing. Because the seller may not have the luxury of walking from the transaction and starting the sale process anew, a re-trade can materially and adversely affect the purchase price and debtor's estate.
- *The melt-down.* If the seller's business is deteriorating rapidly, there may be little remaining value unless the business can be preserved while the assets are marketed or an emergency sale can be held.
- *The end-run.* Debtors seek to obtain value for all constituencies, often through some equitable sharing of the economic pain among different classes of creditors. But unless the debtor takes steps in advance to limit the actions of the prospective bidders, a buyer can "end run" the process by acquiring control of one or more creditor classes. The buyer can then use this control to its advantage and to the potential disadvantage of other constituencies.

From a seller's perspective, distressed M&A requires a specialized skill set both to develop buyer interest and to hold a transaction together at the promised price level through closing. Creating and maintaining a spirited competition (while maintaining the support of lenders and trade vendors) requires a combination of art and science and is the best way to maximize value for a seller. Skilled investment bankers can play key roles in obtaining higher values for distressed sellers.

[2] Buy-Side Practices

A clever, creative and able buyer can take advantage of a distressed seller to buy assets at attractive price levels. In a financial environment where M&A transactions of healthy businesses occur at relatively expensive levels, this ability to buy

cheaply is clearly attractive. The availability of the bankruptcy process to consummate a distressed transaction is a powerful tool in the buyer's arsenal.

Even otherwise financially astute buyers may require guidance in (1) valuing a business whose true financial picture may be unclear, (2) using the chapter 11 process to their own advantage, (3) crafting winning strategies to acquire assets for the lowest price and minimize or avoid a competitive process, (4) designing new securities (to use as acquisition currency) where appropriate, and (5) negotiating with the various parties-in-interest.

On the buy-side, together with counsel, the investment banker is instrumental in developing and implementing the financial strategies that will enable the client to consummate a transaction at the lowest possible price.

¶ 31.02 THE ROLE OF THE INVESTMENT BANKER

Investment bankers are the financial quarterbacks of financial restructuring and distressed sale processes, in respect to both private and public companies. In distressed situations, a seasoned investment banker can provide many financial advisory services, including M&A services.

Retaining investment bankers is usually desirable in cases involving (1) reorganizing companies with complex capital structures, (2) the sale of assets to maximize going-concern value, (3) multiple classes of public debt, (4) the need to raise additional capital, and (5) different classes of creditors with competing priorities and financial interests.

There is a critical distinction between investment bankers specializing in healthy company M&A transactions and investment bankers experienced with distressed matters. The latter group must have the same core group of basic M&A skills required for healthy situations, plus the additional skills required for insolvency M&A. This chapter focuses on the skill set required to specialize in transactions involving financially distressed companies.

There is another distinction between investment bankers engaged in M&A activities within the insolvency field and other financial professionals working with distressed companies, such as accountants. These latter professionals generally are not broker-dealers and do not possess the requisite capital markets expertise, expertise in designing securities, real-world valuation skills and experience, and/or M&A capabilities of a seasoned investment banker.

Whether on the buy-side or the sell-side, the investment banker experienced with financially distressed companies will start by performing a financial assessment of the debtor's overall situation and determining the available options (and the values associated therewith). Such options can include M&A transactions, external equity and debt financings, and an internal financial restructuring. This analytical process, together with input from the debtor's various constituencies regarding their expectations for recoveries in the case, will form the basis for developing the appropriate strategy or strategies.

Thereafter, if an M&A process is one of the strategies selected, scenarios

can include both the sale of distressed companies and the sale of subsidiaries (both healthy and distressed) of a distressed parent company. The ultimate implementation may entail negotiation among multiple constituencies, as well as arranging for the sale of claims or interests in order to facilitate a transaction.

A critical role of the investment banker is to maintain pressure on the various constituencies through closing of the transaction. Without such vigilance and tenacity, and without knowledge of "real world" capital markets alternatives, the transaction (and the purchase price) may deteriorate drastically. For example, a seller may be forced to accept a markedly lower sale price or a buyer may find itself left at the altar at closing. An investment banker seasoned in distressed M&A may be the best insurance policy a buyer or seller (or a seller's creditor committee) could have to realize their goals.

¶ 31.03 COMPENSATING THE INVESTMENT BANKER

When engaged in transactional activities, such as M&A services, investment bankers typically price their services on a "value added" or incentive basis. This tradition runs counter to the prevailing conventions in bankruptcy court, where most professionals are typically compensated on an hourly basis. As a result, a hybrid compensation system for investment bankers has developed. Most bankruptcy courts permit investment bankers to earn incentive compensation, and many allow nonhourly periodic compensation as well.

Because of the financial uncertainty associated with bankrupt companies, investment banking compensation also is subject to collection risks if the amount of secured debt is large in relation to the expected transaction value. Accordingly, investment bankers often seek a "carve-out" of the secured lenders' collateral in order to enhance the prospects of receiving payment.

[1] Success Fees

For M&A transactions involving insolvent companies, success fees (or fees based on a consummated transaction) are an important part of the investment banker's compensation. In nonbankruptcy M&A practice, it historically has been customary for the investment banker to receive up-front payments that may be credited, in some percentage, against a success fee that itself is based on a percentage of the deal size.

The success fee is so named because it usually is payable only on successful consummation of the transaction, and this tradition has carried over into the bankruptcy arena. Success fees typically apply to the total consideration received by the seller and its constituencies, and fall into various categories:

- *Fixed percentage.* The investment banker will receive a pre-agreed percentage of the proceeds from the transaction. For smaller transactions, the percentage may be 4 percent or higher, whereas for larger deals, the percentage may be as low as the 1 percent to 2 percent range.
- *"Lehman" formula.* The Lehman formula (or one of its variants) is frequently used in connection with small transactions and provides that the investment banker receives 5 percent of the first million dollars of sale proceeds, 4 percent of the next million dollars, 3 percent of the next million dollars, 2 percent of the next million dollars, and 1 percent of any subsequent proceeds.
- *Increasing formula.* Sometimes sellers wish to give investment bankers extra incentive to obtain a higher price. Accordingly, they may negotiate a formula that gives a certain percentage up to a threshold level and a higher percentage thereafter.
- *Flat fee.* Under certain circumstances, it may be appropriate to have a fixed success fee that does not vary based on ultimate transaction size. This is particularly true on the buy-side, when the acquirer does not want the investment banker's compensation to increase as the purchase price goes up. Flat success fees also may be used in connection with payment for a successful internal restructuring.

Most bankruptcy courts allow investment bankers to be retained on the basis of success fees. The proper time to evaluate the propriety of the percentage size of a success fee is at the retention hearing for the investment banker. Once the investment banker commences work in reliance upon a set percentage success fee, then the court-approved terms and conditions of employment should apply irrespective of time spent or the ultimate dollar size of the fee.

Certain courts approach success fees in a manner that may deter investment bankers from accepting an engagement in those particular courts. Such courts rely on § 328(a) of the Bankruptcy Code (the Code), which provides, in pertinent part, that:

> [N]otwithstanding such terms and conditions [agreed upon earlier with court approval], the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.[1]

Thus, a court, at the time when fees are ultimately approved for payment, may depart from the agreed-upon payment terms, but only if after-arising facts establish that it is "improvident" to approve the payment of the agreed-upon investment

[1] 11 U.S.C. § 328(a).

banking fee. Since the ultimate approval of fees is subject to considerable judicial discretion, the investment banker and its counsel should plan the initial retention process in a way that minimizes subsequent challenges to the fee arrangements. Adequacy of notice to parties in interest and the extent of disclosure regarding how and when fees will be earned and paid are factors that require close attention.

Unless the buyer is a "co-proponent" of a plan of reorganization, buy-side success fees are not subject to court approval, and a typical buyer's retention of an investment banker is not subject to court approval.

[2] Periodic Fees

Workouts in general, and particularly bankruptcies, carry a number of risks for investment bankers' transaction-related compensation, including the possibility that (1) the business will deteriorate too rapidly to be able to effect a sale and generate a success fee, (2) the net proceeds from sale will not be sufficient to pay the secured debt in full so that the success fee can actually be paid, (3) the debtor's management team may be terminated and a new management team may adopt new strategies and terminate the investment banking engagement, and (4) a court can decide after the sale is completed that the previously approved fee arrangement should be modified.

Investment bankers frequently perform a broad range of financial advisory services in bankruptcy, which can include M&A activities. As a result of these additional duties and the foregoing risks, investment bankers typically seek periodic compensation. Periodic compensation for the debtor's investment banker generally takes one or more of the following forms:

- *Up-front or minimum fees.* A significant amount of an investment banker's work (and value-added) is performed during the early stages of a bankruptcy case. In recognition of this, as well as the compensation risks faced by investment bankers in bankruptcy, investment bankers may bargain for a significant up-front fee, which may be roughly analogous to a "signing bonus."
- *Monthly fees.* Most investment bankers seek a monthly fee during the course of their engagement. An examination of compensation arrangements with experienced investment banking firms in medium to large chapter 11 cases shows monthly rates ranging from $50,000 to $250,000, exclusive of transaction or success fees and sign-on bonuses.
- *Hourly fees.* Certain courts do not permit monthly fees for investment bankers and instead impose an hourly billing system similar to that followed by lawyers and accountants, including maintenance of time sheets.

Depending on the circumstances, some or all of the periodic fees may be creditable against any success fee.

On the buy-side, fee arrangements vary widely, but a typical structure involves an up-front payment, some portion of which may be creditable against a success fee.

[3] Indemnification

In nonbankruptcy M&A practice, investment bankers routinely obtain broad indemnification from their clients. Simply put, indemnification for this purpose means that the client will bear the financial costs of defending the investment banker for any actions taken during the course of the engagement, with certain exceptions. In today's litigious society, indemnification is appropriate to protect professionals from disgruntled parties-in-interest (of whom there are many in a chapter 11 context) who may not like the outcome of a case and seek scapegoats.

However, some bankruptcy courts have not followed standard commercial practices in matters of indemnity. The customary commercial practice enables the indemnified party to be made whole in connection with litigation, except for its own actions that constitute recklessness or willful misconduct (or other similarly high standard). In recent years, some courts have held that investment bankers are not entitled to be indemnified for their own actions, even at a lower threshold of materiality, such as simple negligence. As a result, investment bankers in many cases are only receiving limited indemnity protection and sometimes obtain no indemnity at all.

[4] Engagements and Fee Applications

If engaged by the debtor or an official committee of the estate, an investment banker must be retained pursuant to a court order. Employment of investment bankers is subject to strict court scrutiny, and the provisions of the Code and Bankruptcy Rules are detailed, but not always clear. In brief, the Code provides that any professional employed by a debtor must be a "disinterested person." As a result, investment bankers cannot be employed if potential conflicts of interest exist, such as having raised capital for the debtor or being on the debtor's board of directors. Bankruptcy courts may also exercise their discretion and decline to approve employment for investment bankers on the grounds that their work may be unnecessary or duplicative of that of other case professionals.

The terms of compensation, the duties to be performed and other conditions of retention (such as indemnification of the firm by the debtor) are enumerated in the engagement letter, which is then approved by the bankruptcy court upon application on proper notice. To prevent subsequent attacks on compensation, the engagement letter and the retention application should fully disclose all material facts relating to the retention. A detailed explanation of how a success fee will be earned may be helpful in preventing subsequent attacks on the fee arrangements.

Most bankruptcy courts and U.S. trustees require investment bankers to submit fee applications for success fees and hourly or periodic fees prior to receiving compensation. Monthly fees may sometimes be paid without the need for such submission, although fee applications must subsequently be filed and approved in relation thereto. Fee applications must provide sufficiently detailed and accurate information to enable the court to independently evaluate what level of fees is actual, necessary and reasonable.

Bankruptcy judges have discretion in determining fees and will be reversed only upon abuse of discretion. Abuse of discretion could arise if the bankruptcy judge failed to apply the proper legal standard or followed improper procedures in determining the fee award or based an award on clearly erroneous findings of fact.

¶ 31.04 INVESTMENT BANKING SERVICES

In bankruptcy, in addition to decisions regarding actual transactions and reorganization negotiations, sellers must deal with (1) cash management, (2) the rehabilitation of the business, and (3) maintaining a credible dialogue with the various constituencies in the case and regularly providing them with information.

The presence of a skilled investment banker allows the client to focus on the operational aspects of the restructuring—leaving more of the issues relating to the development and implementation of the transaction for the financial and legal professionals.

Because the success of a chapter 11 case may depend on both actual business progress and the creditors' evaluation of management's abilities and performance, management cannot afford to permit distractions at the very time the operations need its attention most. Moreover, management may have little experience in disposing of assets in a distressed setting, since this is a task that most management teams will not have performed on a regular basis. Finally, a sale process requires skills and organizational back-up that managers will not have.

By contrast, the investment banker is experienced in the sale of businesses in a distressed context, is a skilled and dispassionate negotiator not burdened with the emotional baggage associated with earlier corporate strategies, and also is likely to have (or be able to quickly develop) a "Rolodex" of potential buyers more complete than that of management. Further, placing primary negotiating responsibility with one set of professionals also eliminates the inadvertent undermining of negotiating positions and assures control over the flow of information to the potential buyers.

In sum, an experienced investment banker will be skilled at stepping into a potentially chaotic situation and imposing order on it, by means of (1) expeditious analysis and (2) timely recommending and implementing various courses of action to the advantage of either seller or buyer, as the case may be.

[1] Developing the Debtor's Strategy

Upon being engaged, the investment banker brings a fresh perspective to the restructuring. A good investment banker will be skilled in quickly evaluating a new situation, which could include financial and operating crises, creditor unease, the need for fresh capital when access to the capital markets may be limited or simply a need to capture the going-concern value of a business before it deteriorates into a liquidation. The investment banker will not necessarily have any responsibility for operational oversight, but the client will find it invaluable to engage an investment banker who has expertise in evaluating operations and who can assist the debtor in making decisions to rationalize its business and to generate cash.

Because the investment banker lives in the world of capital markets and M&A transactions, it can give the client much more realistic advice than would other types of financial professionals whose expertise lies in "internal" tasks, such as auditing or monitoring the business or providing financial information to various constituencies.

At the outset of an engagement, an investment banker's tasks may include:

- Determination of the value of the debtor's businesses, both individually and collectively, under various market scenarios. Analyses in such regard may include (1) discounted cash flow, (2) comparable public company, (3) M&A transaction, and (4) statistical analyses such as regression. Discounts may need to be applied to the foregoing, depending upon the circumstances.
- Assessment of the near-term cash flow prospects of the debtor, including an evaluation of whether the debtor is cash self-sufficient and, if not, whether near-term cash could be obtained through borrowings or a combination of business rationalization and asset divestitures.
- Analysis of the debtor's longer-term projected income and cash flow statements, including the reasonableness of the financial and economic assumptions underlying the numbers.
- Determination of the ability of the debtor to effect an internal reorganization and comparing likely reorganization values against likely sale values.
- Determination of the debtor's ability to attract equity or debt for the businesses and likely terms.
- Valuation of the debtor on the basis of a liquidation under chapter 7 of the Code.
- Arrangement of debtor-in-possession (DIP) financing.

The outcomes of these tasks are pivotal in advising a debtor as to its options, which include an internal reorganization, sales of assets, the raising of new capital, or a combination thereof. Factors that could influence the directions chosen are:

- *Immediate sale.* If cash resources (including additional borrowings) are inadequate to fund the restructuring process, the debtor may be forced to sell some or all of its assets quickly or face the prospect of liquidation.
- *Longer-term sale.* Depending on market conditions, the debtor's prospects for effecting an operational turnaround, and the availability of liquidity to fund operations, the highest value for the debtor's businesses may be obtainable through a more deliberate merger process. Use of the merger market to effect the divestiture of a subsidiary or division can provide the additional consideration that can make a restructuring of the core business sufficiently palatable to obtain the approval of certain creditor constituencies.
- *Internal restructuring.* A debtor may elect to seek an internal restructuring if (1) the business can support enough debt (or can attract sufficient equity capital) to satisfy creditor demands for liquidity (i.e., the creditors wish to obtain consideration that can easily be monetized) and (2) turnaround prospects are bright enough that the newly issued equity securities will have sufficient value in comparison with merger market alternatives. Over time, if the business plan is achieved, such an internal plan may provide the highest aggregate recovery of any alternative.

The debtor may choose, as strategic courses of action, one or more of such alternatives and may elect to pursue one or more alternatives simultaneously. This can result in the debtor creating its own competitive dynamic; the threat of an independent, internal plan of reorganization can spur bidders, discourage "low ball" bids and protect against the re-trade. The investment banker will be instrumental in executing the selected strategies.

Once the initial direction is set, the tasks of the debtor's investment banker will include:

- Developing the appropriate consummation methodology (i.e., a sale through a plan of reorganization or through the bankruptcy auction process), depending on issues such as timing, the level of bids in relation to creditor claims, and the composition of the creditor constituencies;
- Anticipating and avoiding potential sale derailments;
- Assisting in the preparation of and in negotiating the sale contract with the buyer;
- Designing new securities to help bridge gaps between the buyer and the debtor's various constituencies;
- Testifying in court regarding (1) the fairness and scope of the sale process, (2) the relative values of the sale consideration in comparison with reorganization or liquidation values and other alternatives, and (3) the value of any securities issued in connection with the acquisition (or in connection with a plan of reorganization).

If the debtor decides to pursue a merger market alternative, its investment banker must develop a comprehensive sale program that will put the seller in the best possible position to maintain and maximize sale value through a competitive process.

The focus must be on the creation of a spirited auction—all investment banking efforts must be directed towards that goal. A single buyer likely will mean a low price, while multiple buyers bring with them the possibility of an auction and, hence, competitive bidding, to the estate's advantage.

¶ 31.05 BUY-SIDE CONSIDERATIONS

From the buyer's perspective (whether a strategic or "financial" buyer), having an investment banker on its team is useful in creating and executing the overall game plan, including (1) establishing whether the target should be the debtor as a whole or selected assets, (2) determining appropriate purchase price ranges, (3) identifying likely competitive bidders, and (4) establishing the merits and practicalities of various acquisition strategies (including acquiring controlling positions in the debtor's claims and interests). The goal of these analyses is to create a series of advantages for the buyer vis-à-vis other competing bidders. (See ¶ 31.14 for a discussion of buy-side strategies.)

Once the game plan is determined, the investment banker will assist the buyer in pursuing the target through negotiations with the debtor and the other relevant constituencies, such as the creditors' committee. A key part of the investment banker's job is to ascertain what elements of a deal could make the transaction attractive to enough constituencies so that the buyer can obtain control at an attractive price.

The investment banker also needs to advise as to the best implementation vehicle (e.g., a plan of reorganization or a bankruptcy auction sale) so that the agreed-upon transaction can be consummated in a way that, to the extent possible, minimizes the risk of being overbid by another bidder prior to closing. Finally, an investment banker may be called upon to testify in court, on behalf of the acquirer, regarding the value of any new securities to be issued in connection with an acquisition.

¶ 31.06 VALUATION OF THE BUSINESS

Valuation views drive many strategic and tactical decisions made by both sellers and buyers. The valuation work and approach in many such situations are as much a black art as science, and the quality of the valuation work performed is critical to success.

On the sell-side, the debtor and the creditors (together with the court) need to understand the values of the enterprise as a whole, together with those of its component parts. In order to determine strategy, they also need to understand

how those values may differ among the public, private, and merger markets. These judgments clearly are within the domain of the investment banker.

In the case of a troubled company, its recent operating performance may make direct analytical comparisons with other (often healthier) companies quite difficult. Deriving accurate valuation views frequently requires the seasoned judgment of a capital markets or M&A professional who has had relevant transactional experience, particularly with distressed and turnaround situations.

The investment banker may be called on to defend its valuation views through court testimony, often under hostile circumstances. In many cases, an investment banker's ability to testify well is a key component of success.

The significance of valuation for buyers is well illustrated in the case of *In re MiniScribe Corp.*[2] MiniScribe Corporation, a $600 million public disk-drive manufacturer, had funded its rapid growth over several years with bank and public debt. In 1989, new management uncovered significant fraudulent activities and, soon after, MiniScribe began to experience a cash crisis.

MiniScribe filed for bankruptcy in early January 1990 and announced that, because of its desperate cash situation, it would seek an immediate sale through a Code § 363 auction.

Maxtor Corporation, a major disk-drive manufacturer, engaged an investment banking firm to advise it in acquiring MiniScribe. Key tasks were to assess MiniScribe's business value, structure a bid, negotiate with creditors, and craft strategies to defeat other interested bidders.

The situation was complicated by the fact that a substantial portion of the asset value of MiniScribe was attributable to two Far Eastern subsidiaries that were insolvent. Because of the investment banking advice it received, Maxtor was the first of MiniScribe's potential acquirers to recognize such offshore insolvency and to develop the appropriate strategy to deal with the issues. A straightforward purchase of the assets would have been uneconomic, because the §363 sale could address only the stock of such foreign subsidiaries and U.S. bankruptcy law was inapplicable to such subsidiaries' insolvency.

Because reliable historical financial statements were not available due to the fraud, Maxtor's investment banker recreated MiniScribe's financial data as a part of the due diligence and valuation work. The investment banker used raw MiniScribe operating data to build recognizable—and credible—forms of financial statements.

The investment banker's valuation process entailed (1) on-site examination of records and discussions with the various operating managers (including MiniScribe's design, manufacturing, and distribution personnel), (2) development of complicated financial models, and (3) application of appropriate valuation methodologies to this data. Development of an acquisition strategy also required the investment banker to project what other buyers might wish to pay for MiniScribe's assets.

The investment banker's analyses provided the underpinnings of Maxtor's

[2] Case No. 90B-1E, petition filed (Bankr. D. Colo. Jan. 1, 1990).

subsequent strategic decisions and was key to Maxtor's success in the sale process. The rapid completion of the due diligence and valuation process also gave the buyer a considerable advantage over competing bidders.

Together with Maxtor's counsel, the investment banker developed a strategy that involved an out-of-court settlement with foreign trade creditors, bank foreclosure on the assets under local laws, and working with the debtor's secured lender on a "credit bid" approach.

Ultimately, just over three months from the original chapter 11 filing, Maxtor purchased the assets in federal bankruptcy court, with the credit-bid assistance of the debtor's secured creditor, at a favorable price that was within the investment banker's original valuation range.

An investment banker's role is heightened when a buyer is contemplating stock as part of the purchase price. Maxtor's winning bid of approximately $85 million included (1) payment of cash and stock for certain assets acquired at auction, (2) payment of cash and stock to certain trade creditors of the Asian operations, and (3) an immediate cash injection for working capital purposes.

¶ 31.07 ADVICE REGARDING SALE TIMING

The investment banker will recommend how and when to sell the business. The timing recommendation is predicated on the following:

- The turnaround prospects of the company;
- Judgments as to its ability to generate operating cash or obtain external financing;
- The degree of creditor support for the debtor;
- Intercreditor dynamics;
- Valuation views about reorganization versus sale; and
- Overall condition of the M&A market in general and the debtor's industry in particular.

If the debtor's financial position is stable, the company may have the time to effect operating turnarounds of its businesses. Because buyers are reluctant to reflect the value of a "turnaround in progress" in the purchase price, a debtor can improve sale value if it can achieve an operational recovery. Conversely, a debtor runs the risk of a lower purchase price by delaying a sale and failing to turn the operations.

A company in serious operational decline may have no alternative but to sell immediately, regardless of the prospects for a turnaround or the condition of the merger market, as illustrated by *In re Intelogic Trace.*[3]

Intelogic Trace, a public company providing computer, telecommunications

[3] Case No. 95-50753-C, petition filed (Bankr. W.D. Tex. Mar. 16, 1995).

and other electronic equipment installation and support services, was spun off from Datapoint Corporation in 1985. By 1994, unable to service its indebtedness, it negotiated a restructuring with its key creditors, which was effected through a plan of reorganization.

After emerging from bankruptcy in December 1994, Intelogic Trace engaged an investment banking firm to explore ways to maximize shareholder value. However, the investment banker immediately became concerned that Intelogic Trace had not adequately reorganized and, in fact, faced a serious and imminent liquidity crisis.

Immediate steps included hiring a crisis manager in January 1995 coupled with negotiation of lender concessions, including the availability of additional capital in February 1995. However, Intelogic Trace's cash deficit continued to increase, and its operational deficiencies quickly proved fatal. When Intelogic Trace ran out of cash again in March 1995, the lenders were not willing to make further concessions.

While management was focusing on solving the operational difficulties, the investment banker had commenced preparation for a rapid sale process and was ready to address the Intelogic Trace's dire circumstances through a broad buyer contact program.

During the next three weeks, the investment banker (1) contacted over 100 potential purchasers, (2) together with counsel, commenced negotiations with a lead buyer and completed definitive documentation to sell Intelogic Trace's assets within a four-day period, (3) arranged for the lead buyer to extend interim credit in a position junior to the Intelogic Trace's secured creditors, and (4) assisted counsel in orchestrating a new chapter 11 filing and an emergency asset sale.

Such sale was completed 10 days after the new chapter 11 filing and just two weeks after execution of the definitive documentation with the lead buyer.

By recognizing that Intelogic Trace was not reorganizable and that the only viable alternative to liquidation was a quick sale, and through proper preparation and a skillfully orchestrated process, the investment banker was able to capture going-concern value for the estate, including the payment in full to the secured creditors.

¶ 31.08 OVERVIEW OF DUE DILIGENCE ISSUES

The realm of "due diligence" is a pivotal area for the investment banker, on both the sell- and buy-sides. (See ¶ 31.08[4] for a discussion of buy-side due diligence issues.)

On the sell-side, a signal role of the investment banker is to develop and present information about the seller for buyers. The seller cannot "win" a good sale at the due diligence level, but it can certainly "lose" bidders here. If the sell-side due diligence tasks are executed correctly and professionally, buyer confidence in the reliability of the data and the overall sale process can be enhanced. Con-

versely, if buyers either receive inadequate information or become concerned about the credibility or quality of the seller's information, the sale process will suffer, perhaps irrevocably.

Key due diligence-related tasks performed by the seller's investment banker are (1) its own up-front due diligence (in order to understand well the seller's particular business), (2) preparation of one or more confidential information memoranda (CIMs), (3) preparation of a buyer list, and (4) shepherding buyers through the due diligence processes (including assistance to the seller in preparing a data room where key documents can be examined by buyers).

Ideally, an investment banker has months to prepare such information and carry out those tasks, but in the distressed M&A context, that luxury is rare, as the time frames for consummating a sale are inevitably short. The presence of numerous potential bidders may create a "high class problem", particularly in a fast-track sale process, as multiple bidders can serve to further complicate and expand the investment banker's front-end work in the sale process.

[1] Confidential Information Materials

Particularly when the merger market environment is ebullient, sellers may have to compete for the attention of potential buyers. The investment banker running any sale process will be far more successful if it can present to potential bidders a compelling, articulate and complete description of a business rather than a haphazard collection of data.

First-rate offering materials are especially critical to capture and maintain the attention of potential bidders when dealing with a financially troubled seller requiring detailed explanation of its turnaround or other "story." Accordingly, skillful preparation of a CIM is a linchpin of a successful distressed M&A process. The Colfor/Colmach [4] sale is an example of how truncated timetables in a distressed sale process can affect the preparation of confidential information materials.

Colfor and Colmach were subsidiaries (aggregating about $90 million in sales) of ABS Industries, a public company. Involuntary bankruptcy petitions were filed against Colfor (a forging operation) and Colmach (a machining operation) in mid-February 1996, and an investment banking firm was engaged shortly thereafter to sell Colfor and Colmach.

Various circumstances in the case made it a difficult sale process. First, there were allegations of improprieties in ABS's financial statements. Next, the debtors' major customers demanded the right to approve the buyer and advised that they would take their business elsewhere unless an acceptable buyer was in place shortly. Finally, the debtors' lenders were preparing to terminate the line of credit in 30 days.

Because a credible investment banker was engaged to manage the sale

[4] In re Colfor, Inc., Case No. 96-60306, petition filed (Bankr. N.D. Ohio Feb. 13, 1996); In re Colmach, Inc., Case No. 96-60307, petition filed (Bankr. N.D. Ohio Feb. 13, 1996).

process, customers and lenders were persuaded to extend the time for a sale process. However, the pressing need to sell the companies required that the front-end marketing process be dramatically compressed.

Thus, the investment banker was simultaneously (1) on-site, working with crisis management to develop credible historical and projected operating data, (2) developing a buyer list, (3) developing a series of CIMs, and (4) working with counsel to develop a form of contract and approach to the sale process.

Within 30 days, three iterations of CIMs were distributed to buyers; this approach enabled buyers to receive information as soon as it was developed. On-site buyer due diligence visits were conducted concomitantly.

The CIMs contained detailed descriptions of the debtors and their operations, as well as a comprehensive discussion of their business strategies, overall industry conditions, competition and Colfor and Colmach's financial results. Other CIM information included detailed asset registers, updated detailed financial statements, information on customers and suppliers, and reports summarizing operating procedures and manufacturing efficiencies.

Based on its experience in other distressed sale processes, the investment banker aimed at creating CIMs that gave potential investors the materials and information believed necessary to develop a bid—and hence to maximize value to the estate.

In addition to the CIMs, the investment banker prepared and disseminated to buyers sale process updates, time lines, bidding procedures, and draft versions of the sales contract. The timely and effective front-end due diligence process facilitated a competitive bidding process that culminated in the sale of Colfor and Colmach at a highly advantageous price.

[2] Buyer List

Concomitantly with preparation of the seller's due diligence materials, the investment banker will prepare the buyer list. When compiling the buyer list, there are generic categories of potential acquirers on which the investment banker will focus: (1) strategic buyers and (2) financial buyers. Each category has distinct characteristics.

[a] Strategic Buyers

Strategic buyers are those companies that can acquire the asset offered for sale and integrate it into their existing operations. Typically, strategic buyers may be competitors of the seller and/or entities that have previously been active in acquiring companies similar to the seller. Further identification of strategic buyers is achieved through researching public data sources such as industry codes, industry associations and publications, and other industry-related information.

Because of their extreme familiarity with the industry (and perhaps even with the seller itself), strategic buyers will likely need less information to make an investment decision and, thus, can often move more quickly than can a finan-

cial buyer. This comparative edge—particularly in fast-track distressed sales—means that strategic buyers are often "better" buyers than purely financial buyers in a distressed sale process.

Also, strategic buyers often can afford to pay higher prices for assets, as they (unlike a financial buyer) can immediately create economies of scale by melding the acquisition into their existing operations and reducing costs such as corporate overhead. In addition, because they are already operating in the industry, strategic buyers may be less concerned than financial buyers about certain operational issues or concerns (such as contingent risks) that may be endemic to a particular industry.

Assuming requisite financial wherewithal exists, the relative disadvantages of strategic buyers vis-à-vis financial buyers are few but can be meaningful. A putative strategic buyer may have a genuine interest in the offered asset, but may either be a novice at acquisitions in general (and hence could eventually suffer from "cold feet" before consummating the transaction) or be discouraged by the distressed acquisition process itself. Further, some potential strategic buyers may attempt to use the process primarily to learn proprietary information regarding a competitor.

Another notable potential disadvantage is that, depending on the size of a transaction, a strategic buyer may need to evaluate whether the acquisition would run afoul of antitrust laws, a hurdle that a financial buyer will not normally face.

[b] Financial Buyers

A financial buyer is the antithesis of a strategic buyer, insofar as the working definition of a financial buyer is a purchaser without complimentary business operations. Financial buyers invest in a broad spectrum of situations, ranging from healthy to distressed. The universe of financial buyers who focus on distressed transactions includes formal investment funds, individual "bottom fishers," and other parties who find the world of distressed investment attractive.

Locating financial buyers is more difficult than identifying strategic buyers; there is no SIC code for financial buyers, and they exist in various locations and forms around the country. The investment banker who specializes in distressed transactions will be familiar with those investors who regularly traffic in bankruptcies and restructurings and who acquire companies through the bankruptcy process.

As with buyout funds that target healthy companies, many financial buyers in the distressed world will have regional preferences (financial buyers usually want to be physically near the acquired assets), size parameters and industry preferences (i.e., most financial buyers will not pursue just any distressed transaction). Moreover, unless already familiar with the subject industry, the financial buyer may need more time and information to develop definitive views of pricing and interest to consummate a transaction.

Financial buyers generally require higher investment returns levels than do strategic buyers and, thus, in a competitive situation may not be in a position to

pay as much for an asset or company as will a strategic buyer. On the other hand, under certain circumstances financial buyers may have greater financial wherewithal than a strategic buyer, and money managers or other investment groups under pressure to put funds to work may outbid strategic buyers simply to consummate a transaction.

[3] The Seller: Orchestrating Due Diligence for the Buyer

The seller's investment banker must present the business to buyers in a straightforward, fair manner. A favorable spin is permitted in practice, but only as long as all material facts are clearly presented and there is full disclosure of the risks and substantive problems in the business.

The buyer must have no reason to believe that relevant or material information is being withheld. The seller who runs a process where the asset's warts are purposefully hidden and/or glossed over in the due diligence stage is playing a most dangerous game, even where the transgression does not rise to the level of fraud. Apart from the damage to the adviser's reputation if this course of action is used and subsequently unearthed, the client will suffer if a party-in-interest or aggrieved buyer (or even a losing bidder) brings the tactic to light.

Because due diligence usually precedes contract and other negotiations, a loss of credibility at the due diligence level will cascade throughout the rest of the process, to the seller's detriment. The investment banker can play a key role in enhancing or detracting from the credibility of the due diligence.

A skillful due diligence process can facilitate the bidding process as well as the consummation of a transaction. A fair and full due diligence process should result in a bidder population that is quickly well-informed about the asset or business offered for sale. In short, because a "well-educated consumer is the best customer," a properly administered due diligence process can be a key ingredient in the seller's efforts to maximize value.

Certain due diligence issues within the purview of the investment banker include:

- *Confidentiality agreements.* The investment banker will negotiate appropriate confidentiality agreements with bidders that will both (1) restrict use of proprietary information gained through the due diligence process and (2) preclude bidders from acquiring, or offering to acquire, claims or interests without the debtor's permission. This will reduce the likelihood that the seller will face a "hostile" or uncontrolled situation.
- *Level playing field.* The investment banker will be mindful of the need to maintain a level playing field or full and fair access to all qualified potential bidders. This means that the seller does not favor any particular party, but instead provides all interested potential purchasers with the information necessary to make a definitive bid, while minimizing management distractions.

- *Offering materials.* Developing offering materials, including a CIM and a data room to be used by prospective bidders in connection with their due diligence activities, is a key investment banker task.
- *Gatekeeper.* The investment banker maintains control over a complicated process with multiple participants and acts as the client's due diligence interface, or gatekeeper. This will also minimize the massive disruption of business and executives' time that can occur as multiple bidders move through the due diligence process.
- *Information flow.* The investment banker facilitates an ongoing information flow to bidders regarding the overall sale process, including price guidance when appropriate.

[4] The Buyer: Obtaining Due Diligence Information From the Seller

The buyer's investment banker must be able to gather and assimilate information in a relatively rapid time frame in order to meet key sale deadlines. In addition, the investment banker needs to utilize its experience and judgment to determine whether disclosure has been complete and how to obtain better information. Key buy-side tasks include:

- Providing the seller with a comprehensive due diligence document request list;
- Performing on-site due diligence to examine operations;
- Creating projections and evaluations from detailed operating and financial data, if there is fraud or other questionable aspects to seller's financials;
- Preparing financial and operating models for future periods based on the due diligence and the assumptions made about prospective operating and capital structure; and
- Assessing future profitability and ability to satisfy the buyer's investment rate-of-return hurdle requirements.

The MiniScribe case highlights the significance of buyer due diligence (see ¶ 31.06). The due diligence moral drawn there is that, when faced with flawed or fraudulent financial statements, due diligence can nevertheless arm the creative buy-side investment banker with enough tools to develop an accurate financial picture.

From the buyer's perspective, the due diligence process is vital not only to uncover rocks and blemishes, but also because it can assist in developing winning strategies to ward off other bidders, and thus blunt a seller's competitive process.

When several potential bidders are interested in a company, a key buyer goal is to "end run" the competitive bidding process. Due diligence may identify

ways of structuring an acquisition that puts other bidders at a disadvantage. In the following case study, an interested potential buyer of a major consumer products company engaged an investment banker who spearheaded the acquisition strategy.

The buyer's principal had developed a strong relationship with the debtor's major shareholders. The due diligence process uncovered the fact that, while the debtor owned the relevant rights to the consumer product line, the shareholders themselves owned and licensed to the debtor the rights to a highly attractive marketing tool utilized to generate sales of the consumer product line. Further, the bankruptcy court had no direct jurisdiction over the shareholders with respect to assets they owned as individuals.

Based on the investment banker's advice, the buyer signed a contract with the debtor to acquire its assets through a § 363 sale and, separately, signed an option agreement with the shareholders permitting the buyer to acquire the rights, at its unilateral option, to the desired marketing tool (acquiring the consumer product assets without assurance that the marketing tool could also be acquired would have been a high risk). This provided the buyer with a "crown jewel" that would deter competing bidders.

The debtor's creditors vigorously objected when they learned of the option agreement, but it served its purpose because the buyer was able to gain, and maintain, the inside track. Because the competing bidders indeed fell away, the buyer acquired all the desired assets at an advantageous price.

¶ 31.09 THE PURCHASE CONTRACT

The investment banker, in collaboration with counsel and management, should play a key role in the structuring and negotiation of contracts for sales pursuant to both plans of reorganization and § 363 auctions. The investment banker will take the lead role in negotiating business-related points and should have meaningful input on certain bankruptcy-related implementation issues as well.

The initial drafting of a purchase contract is customarily done by the buyer and is generally prepared in connection with the submission of a formal bid. However, under certain circumstances, the seller can achieve both timing and negotiating advantages by disseminating to all potential bidders its own draft contract, together with the confidential information materials. Such advantages include:

- Obtaining the drafting and structure initiative, which can be very important through the negotiating process;
- Encouraging all buyers to work from the same document, thereby facilitating comparison of subsequent bids; and
- Accelerating the bid process, since buyers can start from a draft contract.

This tactic is generally more necessary when the sale-process time frames are short and generally more effective when the seller keeps the provisions of the initial contract relatively balanced between the interests of the two sides.

Because values are improved through spirited competition, the seller's team may find it advantageous to enter into simultaneous contract negotiations with multiple parties. The benefits of competition, however, do not come easily. Both counsel and the investment banking firm must be prepared to deal with the logistical complexities and pressures associated with such multiple negotiations. These professionals must also be able to insulate management from the day-to-day grind of the negotiating process. Management needs to stay focused on the operations and is usually most effective in the negotiating process if used only to resolve key issues.

In a distressed sale, there are numerous issues that need to be resolved between seller and lead buyer, including whether the sale should be consummated in bankruptcy. Following is a list of certain key purchase-contract elements from an investment banking perspective.

1. *Purchase price.* The seller will want the purchase price to be as high as possible and in a form that provides as much liquidity for its constituencies as possible. Conversely, the buyer would like to acquire assets as cheaply as possible, and the desired form of consideration (e.g., cash, stock, notes, or earn-outs) will vary by buyer and situation.

2. *Certainty.* Certainty of closure is an important issue in a bankruptcy sale. There is tension regarding this issue between buyer and seller, because a primary goal of the seller is to close at the promised price, while the buyer wishes flexibility on its obligations to pay the promised price or even to close at all. Whether the seller or the buyer ends up with the relative advantage in a contract depends on the skill of their respective advisers and the level of competition in the sale process.

On the sell-side, the perfect contract is one that has no buyer "outs" for any reason whatsoever other than being overbid. Such perfection is seldom obtained (although the more spirited the competition, the better the contract will be for the seller), but in any event the seller should seek to avoid material adverse change (MAC) outs and buyer financing conditions to closing. Such outs are two of the most important certainty-related problems for sellers.

If the buyer insists on a MAC clause, it is imperative that the contract clearly specify what precise conditions trigger the MAC. This reduces the likelihood that the buyer would be able to walk—or to retrade the price—simply because the debtor's ensuing (between contract and closing) business results are disappointing. In the absence of such specificity, buyers would have much more leverage and latitude, since distressed sellers frequently experience disappointing results.

The buyer's investment banker, conversely, will wish to maintain as many outs as possible.

3. *Downpayment.* In order to keep the buyer honest, the seller's team frequently asks for a down payment or "earnest money" deposit. If the transaction closes, the deposit would be credited against the purchase price. Conversely, if the buyer walks from the transaction for inappropriate reasons, the deposit is forfeited to the seller. In other instances, the money is returned to the buyer.

4. *Liabilities assumed.* In a plan of reorganization, the Code generally provides that pari passu liabilities will receive equivalent treatment. However, in a § 363 auction, there may be somewhat more flexibility. The buyer may wish to give certain creditors (e.g., trade creditors or other constituencies important to the ongoing business) an economic advantage by assuming their claims. Depending on the circumstances, courts may permit this.

5. *Break-up fees and overbid protections.* Break-up fees and overbid protections are often utilized by sellers to attract a lead buyer. When granting such protections, it is good practice for the seller to require that a buyer shed all conditions to close before becoming entitled to any break-up fee. As in all of these contract-related issues, however, the relative leverage between the parties will determine who gets the more favorable terms—emphasizing again the importance of a competitive process to an otherwise vulnerable seller.

6. *Bankruptcy order and closing date.* When acquiring through a § 363 process, many buyers demand that the court order approving the sale becomes final and nonappealable before closing. In practical terms, this means that they want to wait for the expiration of the 10-day appeal period following the court order approving the sale before they will close. Because it is conceivable that a party-in-interest may file an appeal during this time (although it would require a substantial bond to so do), the seller may be left in limbo for the indefinite duration of the appeal.

The safer course of action for the seller is to have the buyer close on the first business day on which the court order approving the sale is unstayed, given that the better view of the law is that as long as the buyer has been found to be a good-faith purchaser pursuant to Code § 363(m), no subsequent appeal can unwind the transaction.

7. *Contingent claims.* Suffice it to say that contingent claims (such as environmental issues) abound in many sale situations and can present a serious impediment to consummation of a transaction. Where such contingent liabilities exist, the seller and the buyer must allocate risk and responsibility in order to resolve the issue. There are many ways to do this, and the investment banker can have a constructive role in crafting a mechanism that works for both sides.

¶ 31.10 SALE VERSUS REORGANIZATION

In certain instances, the debtor's value will be maximized through a combination of (1) divestiture of subsidiaries or divisions together with (2) a reorganization of the remaining core assets. Factors that may lead to this conclusion include:

- Disparate business operations, some of which are not essential to the company's prospective business strategy;
- The need for certain creditor constituencies to receive cash that can be generated through a sale, in contrast to the desire of other constituencies to maximize their recoveries through capital appreciation in the securities of the revested debtor;
- Businesses that are capable of attaining significantly higher value through a successful operational turnaround than through a near-term sale; and
- The presence of significant net operating losses that can be utilized by a reorganized debtor to shelter future profits.

The investment banker needs to analyze each of these, and other, issues to determine whether a combination sale and restructuring approach provides the most value for the estate.

There can be other benefits from a combination approach as well. For example, a plan of reorganization can be used to protect officers and directors of the seller. Protections, such as indemnification and releases (from parties in interest, as well as perhaps from third parties) will only be available, if at all, through a plan of reorganization—and then only to officers and directors in place at confirmation.

Conversely, such protections are not likely to be available pursuant to asset sales through § 363. This can be a serious incentive for a seller to effect at least one sale transaction or an internal restructuring through a plan of reorganization. It should be noted that the scope and availability of protections vary among the different bankruptcy jurisdictions, and that creditors and the Securities and Exchange Commission are usually hostile to such protections. Two cases where value to the estate was maximized through a combination of asset sales and internal reorganization were *In re Sudbury, Inc.*[5] and *In re Tracor Holdings, Inc.*[6]

Sudbury, Inc., a public holding company with over $400 million in revenues, had 23 operating subsidiaries that manufactured a broad range of industrial products. Approximately 70 percent of its revenues were derived from the domestic automotive industry. Given the downturn in the economy (particularly in the automotive industry) in the early 1990s, Sudbury found it difficult to service its approximately $170 million of bank and subordinated debt.

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[5] Case No. 92-10148, petition filed (Bankr. N.D. Ohio Jan. 10, 1992).

[6] Case No. 91-10572-LK, petition filed (Bankr. W.D. Tex. Feb. 15, 1991); confirmed (Bankr. W.D. Tex. Dec. 6, 1991).

An investment banker was engaged in late 1991 to advise Sudbury about a financial restructuring, assist management in evaluating business operations, and lay the groundwork for a postrestructuring operational turnaround.

For about a year (during which time Sudbury had five different chief executive officers (CEOs)), intense negotiations took place among Sudbury, its secured senior creditors, and its unsecured creditors. At the outset of the negotiating process, shareholder value was seriously impaired, and by the time all parties agreed to a restructuring, shareholder value had been eviscerated as gauged by its stock price.

By January 1992, the investment banker's comprehensive plan to restructure Sudbury's balance sheet had been accepted by all parties, and one of the conditions to unsecured creditor approval was that a new CEO be installed. Sudbury then filed a chapter 11 petition in order to implement its consensual restructuring plan.

Elements of such plan included (1) a near-term "non-core" asset sale program to pay down the bank debt, (2) the conversion of subordinated debt into the significant majority of pro forma common stock, together with a $10 million subordinated note tranche, and (3) old equity's aggregate receipt of 5 percent of pro forma common stock together with three series of "participation certificates," which are functionally warrants with varying strike prices.

The participation certificates were aimed at capturing, for old equity, a significant piece of the enterprise value created postreorganization. Depending on Sudbury's stock price performance, these securities could enable old equity to own up to 23 percent of the Sudbury's pro forma equity and at attractive pricing levels. There was considerable skepticism among Sudbury's other constituencies that the participation certificates would ever wind up "in the money."

Pivotal to the success of the reorganization plan designed by the investment banker was the quick sale of nonstrategic assets at targeted price levels. The investment banker assisted Sudbury in divesting certain assets pursuant to the aggressive divestiture program required by Sudbury's senior lenders under the plan of reorganization.

Charged with the responsibility of selling the first two subsidiaries, the investment banker successfully sold the subsidiaries within two months, on time and at the required price levels. This enabled the overall plan and sales effort to meet its initial targets and, with this momentum, Sudbury was set for chapter 11 success.

With the reorganization plan thus underway and because of the new CEO's highly effective managerial efforts, all three series of old equity's participation certificates became "in the money," and old equity went on to achieve an aggregate recovery of almost $30 million, which compares quite favorably to the essentially nonexistent old equity values that existed prior to Sudbury's bankruptcy proceedings.

Tracor Holdings, Inc. was a diversified defense and industrial products company acquired through a leveraged buyout and financed with approximately $1 billion of bank debt and public bonds. Tracor thereafter generated enormous

losses and encountered a liquidity crisis that led to payment default on its indebtedness.

Tracor retained an investment banker to advise on restructuring its financial obligations. The investment banker and Tracor designed and implemented an overall strategy, which contemplated a significant debt reduction coupled with a § 363 sale of one subsidiary and a spin-out of the remaining businesses into two independent, publicly traded companies.

Tracor implemented the restructuring through a prenegotiated bankruptcy plan and was successful in selling the requisite subsidiary through the § 363 process. Because the debtor's investment banker perceived value where others did not, old equity received "ugly duckling" securities (i.e., equity securities in assets that were viewed as unattractive by the financial advisers to Tracor's creditors) that in fact later proved to be extremely valuable.

The plan of reorganization was confirmed, and Tracor represents the only known major bankruptcy case in which (1) a company was split into separate ongoing entities and where banks agreed to split their collateral among such entities and (2) the postreorganization recovery of old equity *exceeded* the recovery of junior creditors.

¶ 31.11 VALUING AND STRUCTURING BIDS

Valuing and structuring bids is a key role for both sell- and buy-side investment bankers. Investment bankers perform this pivotal role in acquisitions through a plan of reorganization, as well as through a § 363 sale.

[1] Sell-Side Considerations

The winning bid in a § 363 auction is the one adjudged to be "highest and best." However, this is not always a straightforward calculation. Key considerations when a seller is evaluating the relative strengths and merits of bids include the following.

1. *Ability to close.* The seller must evaluate the likelihood that a particular bidder will actually proceed to a closing, based on the bidder's financial wherewithal, its track record of completing acquisitions, and the strategic fit.

2. *Comparing "apples and horses."* Frequently, bids will include varying forms of consideration, such as common stock, debt, warrants, "earnouts," and other securities. On occasion, the consideration includes securities of companies that only will exist after the closing. The investment banker must perform a careful analysis of the consideration offered by competing bidders, often under extreme time duress at the time of the bankruptcy sale.