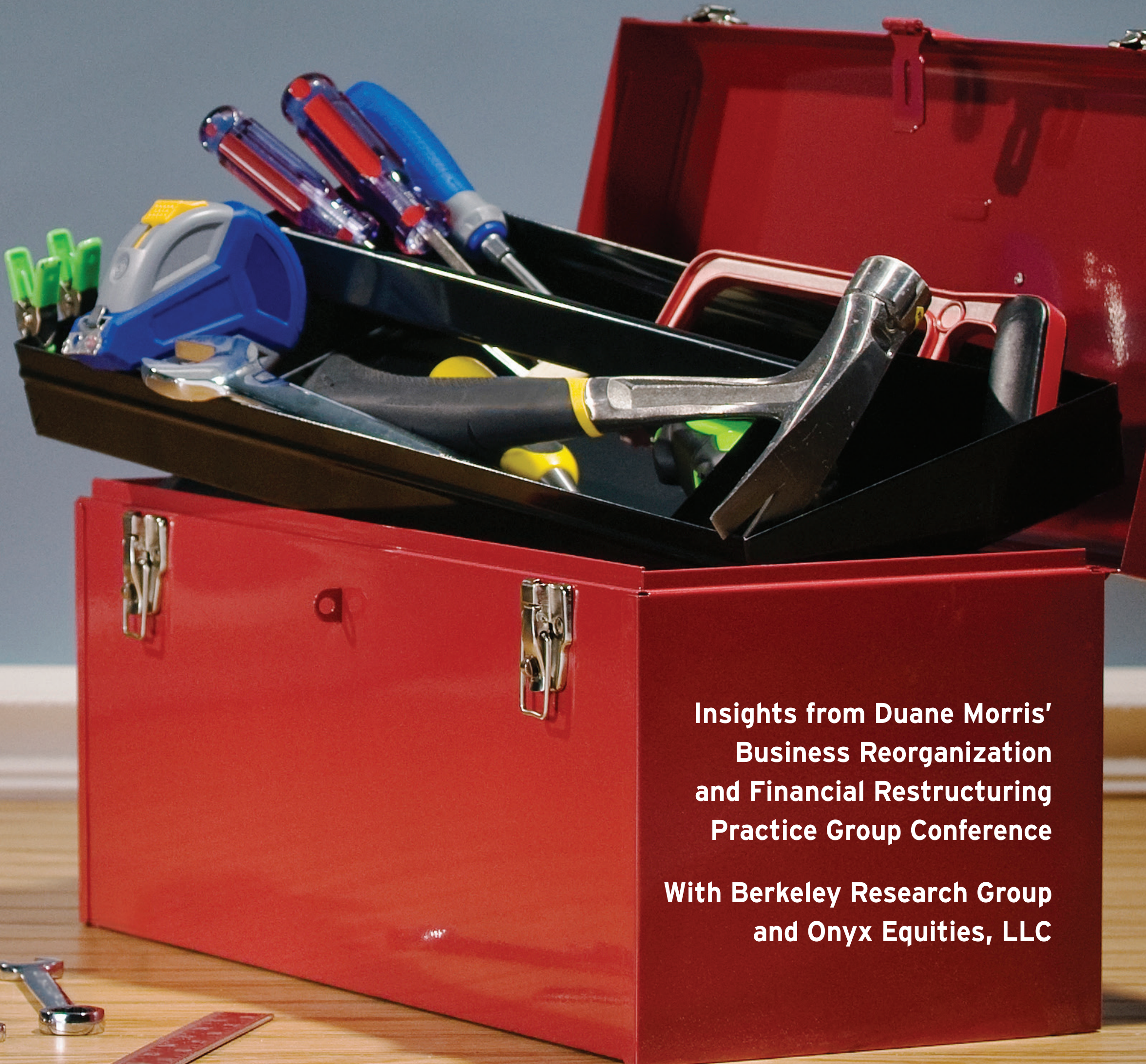
Duane Morris®

SPRING 2016

OPTIMIZE

VALUE FROM DISTRESSED ASSETS

THE TOOLS OF THE TRADE



Insights from Duane Morris' Business Reorganization and Financial Restructuring Practice Group Conference

With Berkeley Research Group and Onyx Equities, LLC

THE TOOLS OF THE TRADE

Working with distressed assets requires choosing the right tools at the right time. A scalpel for precision. A broad brush for negotiations. This form. That device. (If you're still using paperclips, read on.) At a time when legislative reforms to the rules of bankruptcy remain elusive, a wise practitioner keeps the workshop well-stocked, keeping pace with best practices and trends.

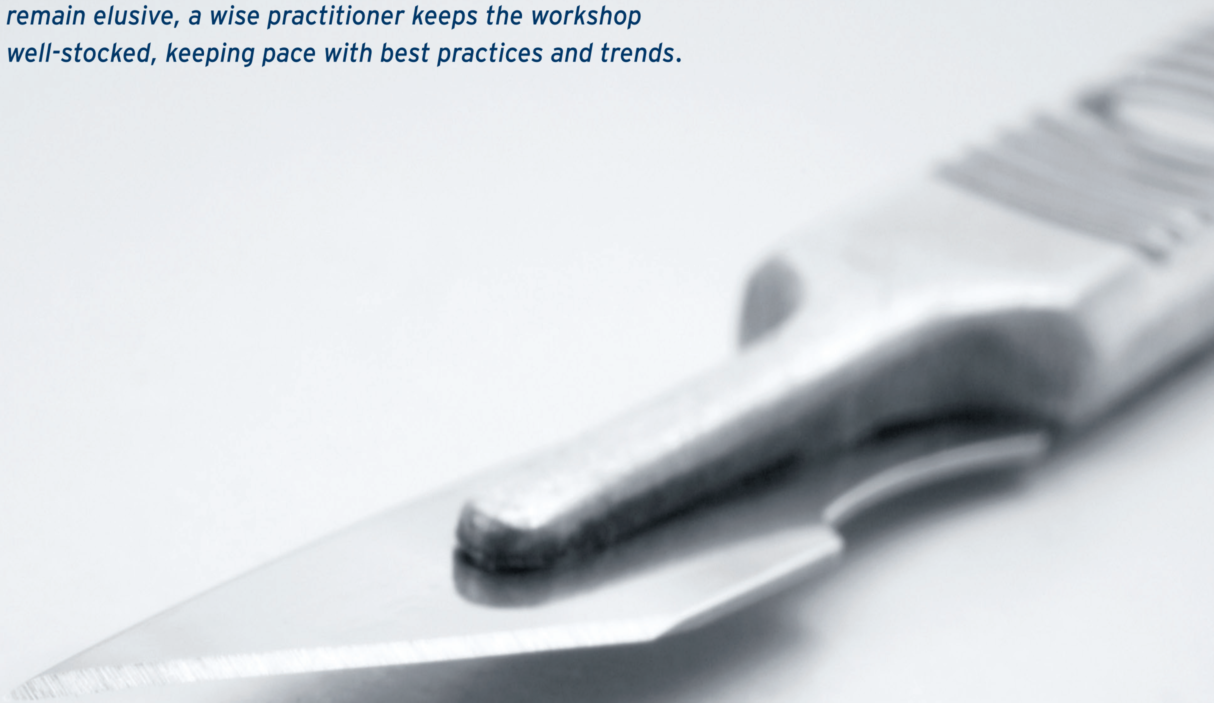


TABLE OF CONTENTS

02 LETTER FROM THE EDITORS

04 THE TOOLS OF THE TRADE: AN OVERVIEW

07 THE STATE OF COMMERCIAL FINANCE

07 WORKAROUNDS, REMEDIES AND PAPERCLIPS

07 RECEIVERSHIP: AN ASSET MANAGEMENT TOOL

08 GETTING THE MOST OUT OF RECEIVERSHIPS

08 CREDIT BIDDING IS ON THE LEVEL

10 THE 363 SALE, POWER DRILL OF THE CHAPTER 11

11 INDUSTRY SNAPSHOTS

13 A WRENCH IN THE CODE

15 SPEAKER PROFILES

17 ABOUT DUANE MORRIS

LETTER FROM THE EDITORS

Finding an edge in an increasingly competitive market requires agile decision-making. A knowledge of your industry. The right tools to solve thorny bankruptcy and restructuring problems. And, of course, a seasoned team when you need help.

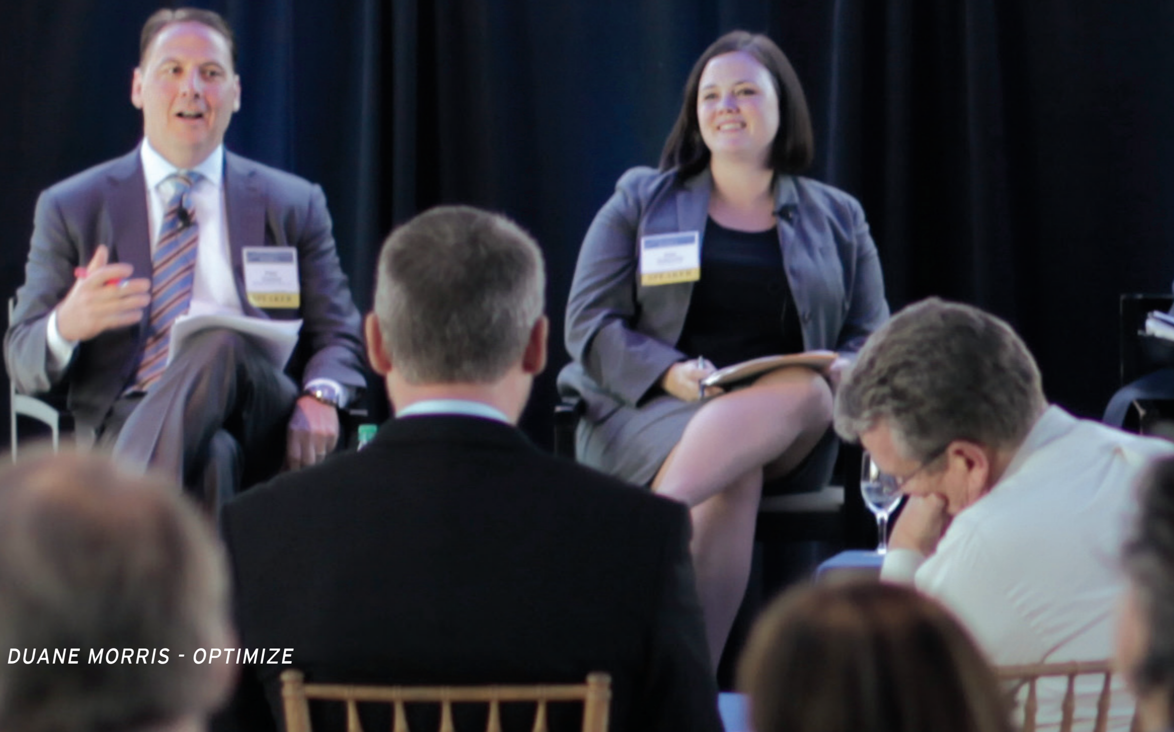
Our job is to create solutions for our clients and keep watch for what may be coming down the pike. In an area of the law that fluctuates according to economic cycles, you can look for answers from lawyers who have seen it all.

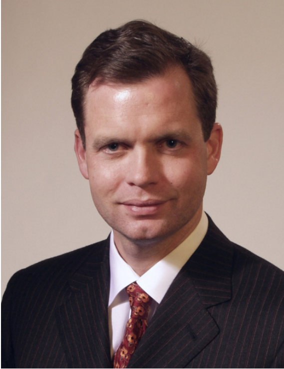
We've been there. For 30 years, the lawyers in the Business Reorganization and Financial Restructuring Practice Group at Duane Morris have brought clients together to share perspectives and wisdom from the field. Recently, we joined forces with our colleagues at Berkeley Research Group and Onyx Equities, LLC to distill and discuss major trends from the past year.

What we learned is this: ***The tools of the trade are both traditional and innovative. Keep them close and ready.***

We hope this fifth edition of our *Optimize* series empowers you to explore new tactics and feel more confident about handling what lies ahead.

From left: Peter Chadwick of Berkeley Research Group expresses his views on the increasingly competitive market as Catherine Beideman Heitzenrater and James Holman, both of Duane Morris; Lauren Lonergan Taylor, a Duane Morris alum now at TD Bank; and Jonathan Schultz of Onyx Equities, LLC contemplate his insights.





JAMES J. HOLMAN

Partner, Duane Morris
Business Reorganization and Financial Restructuring Practice Group

CATHERINE BEIDEMAN HEITZENRATER

Senior Associate, Duane Morris
Business Reorganization and Financial Restructuring Practice Group

THE TOOLS OF THE TRADE: AN OVERVIEW

Physicist Stephen Hawking once noted that "intelligence is the ability to adapt to change."

Entrepreneurs, lawyers, investors and bankruptcy professionals ride the waves of interest rates, credit markets and other changing market factors. We have the tools to navigate all kinds of issues. But take stock: Examine what's in your toolbox and be prepared for your next job. (There is no MacGyver in bankruptcy.)

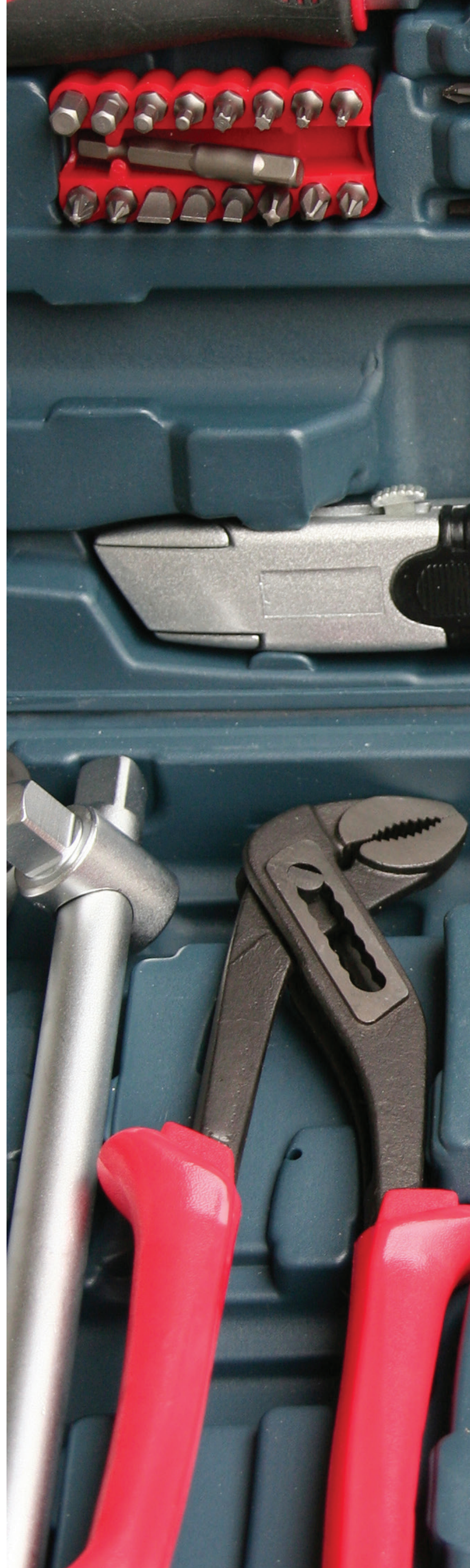
That is why we come together each year.

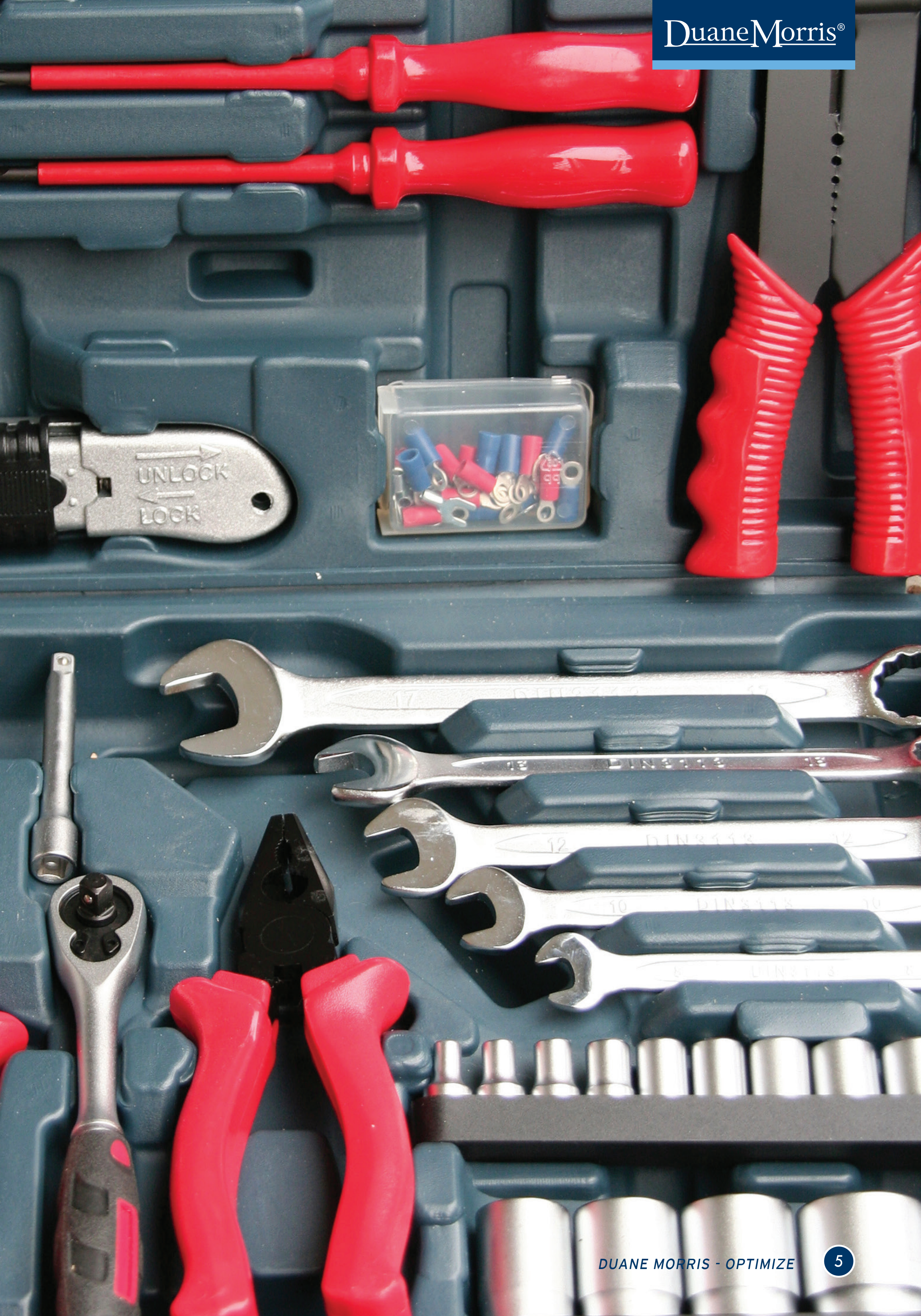
Duane Morris partner James J. Holman moderated our panel discussion, which featured Peter Chadwick of Berkeley Research Group and Jonathan Schultz of Onyx Equities, LLC, along with Duane Morris alum Lauren Lonergan Taylor of TD Bank and senior associate Kate Heitzenrater of Duane Morris.

The takeaway? On the legislative front, it's all talk but no action (yet). In the courts, circuits are split. Professionals in this field are left to innovate and build new structures to achieve their goals.

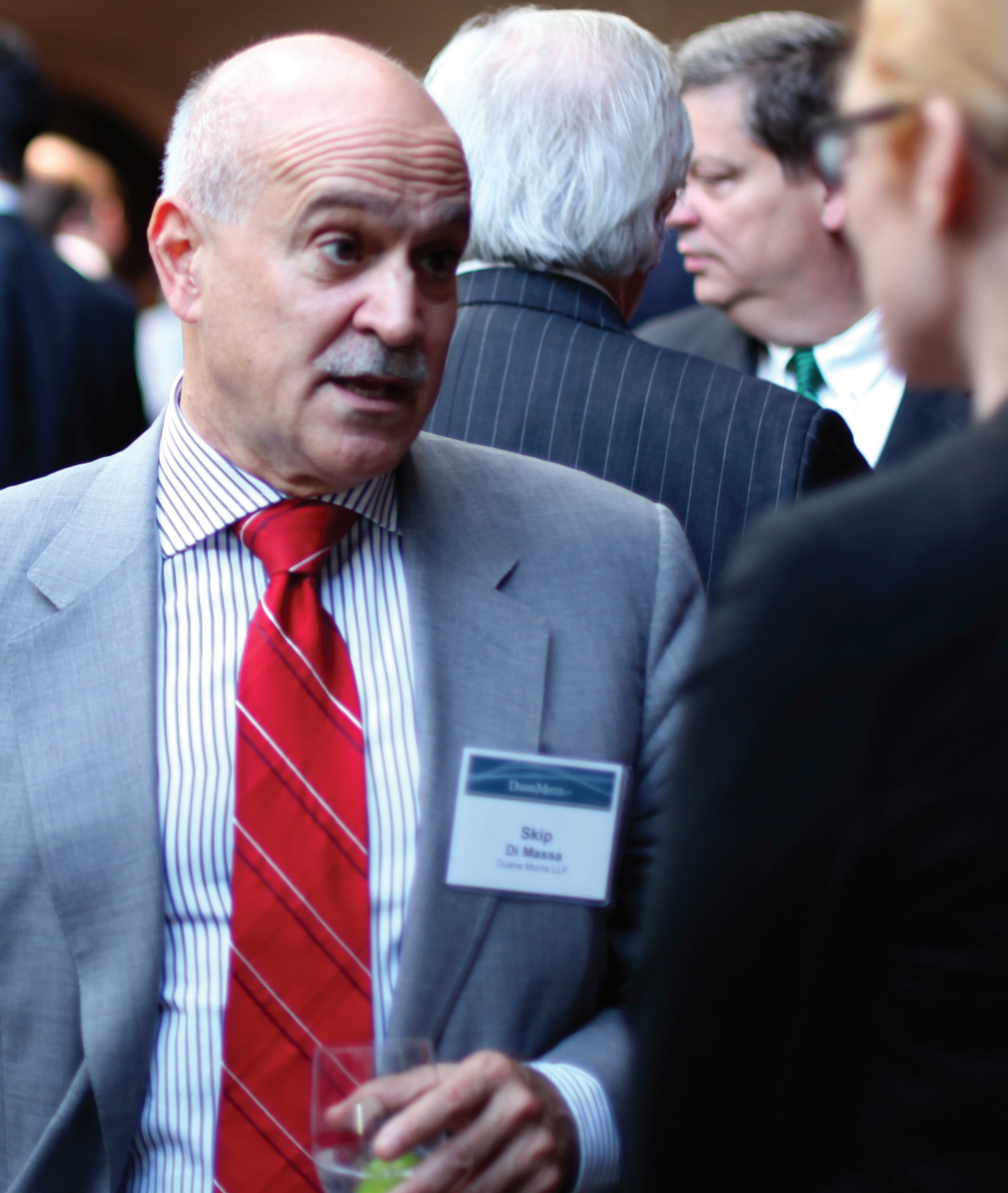
In this issue of *Optimize*, you'll find our perspective on market forces, industry trends, workarounds and remedies, as well as our predictions for the upcoming year. You'll also learn more about what's working and what's not in the courts and in business—along with which tools work, and which don't. (Even office supplies are questioned. Put down that paperclip! See page 7 for details.)

What's in your toolbox?




UNLOCK
LOCK

Duane Morris Business Reorganization and Financial Restructuring Practice Group Chair Rudolph J. Di Massa, Jr., is engaged in a thought-provoking discussion based on the topics addressed at our program.



THE STATE OF COMMERCIAL FINANCE

Economic winds have not shifted much since our last edition of *Optimize*. "There is still abundant liquidity," said Duane Morris partner James Holman. "The search for higher yields continues to dominate investor outlook. Interest rates remain steady. There's a perpetual threat of interest rates rising." Spreads are tight, and commodity prices continue to drop.

Consumer spending is down. Inflation is still very low. Exports have declined for the first time since 2009. If there is one change, said Berkeley Research Group's Peter Chadwick, it's that "companies that previously weathered a storm by tapping high-yield markets may not have access to those markets today."

Holman noted that our clients and their professionals have adapted many workarounds in an environment that has been slow to change on the legislative front. Dealmakers can work around restrictions. "We've seen a lot of new structures come into place," he said.

> "... companies that previously weathered a storm by tapping high-yield markets may not have access to those markets today."

WORKAROUNDS, REMEDIES AND PAPERCLIPS

Borrowers continue to use chain of title challenges to try to stave off asset foreclosures. In *HSBC Bank v. Roumiantseva*, a paperclip tipped the scales in favor of the defendant-borrowers. The lender had attached the endorsements to a promissory note, called the allonge, with a paperclip, instead of writing the endorsement directly on the note itself. The court dismissed the lender's foreclosure complaint, finding that the lender had failed to demonstrate it was the holder of the note.

Lesson learned: If you need a separate piece of paper for the allonge, affix it so the note becomes an extension, or a part of, the note itself.

RECEIVERSHIP: AN ASSET MANAGEMENT TOOL

Lenders frequently turn to receiverships to manage assets and even dispose of collateral. An appointed receiver, of course, is a party who maintains custodial responsibility for property, assets and other rights. The receiver controls the property, its maintenance and insurance. "Having a receiver in place helps ensure that you're not deemed a mortgagee in possession by virtue of collecting the rents," said Duane Morris alum Lauren Lonergan Taylor, now at TD Bank.

GETTING THE MOST OUT OF RECEIVERSHIPS

Receiverships can be unpredictable, said Taylor, as there is no uniform set of rules. Do you have the right under applicable law to appoint a receiver? If so, what can the receiver be empowered to do?

- Consider your form of order. "Think of it like your wish list," said Taylor. "Throw everything in there that you could possibly ever want out of the receivership." It's the key to the scope of the receiver's powers. Make sure to propose a receiver by name, even though it is ultimately the court's decision who will serve as receiver.
- Pick the right receiver. Does your receiver have experience managing properties of a similar size and type to the asset at issue? Talk to your proposed receiver before you submit your form of order to the court to make sure your proposed receiver can deliver what you need if appointed.
- Be precise about collection and use of the income stream. Is there a cap on the receiver's expenditures after which lender consent is required? Can the receiver hire outside counsel or other professionals whose services will be compensated from receivership assets?
- If you have distressed assets in more than one state, think about utilizing federal court for your foreclosure action. The federal court's jurisdiction could extend to receiverships across state lines.
- Give the receiver the power to market and sell the property. "The lender is more likely to realize a greater price from a receiver sale than from credit bidding the property at sheriff's sale and then having to resell the property," noted Taylor. "You avoid all the carrying costs after taking the property back at sheriff's sale and, of course, transfer taxes when you ultimately resell it."

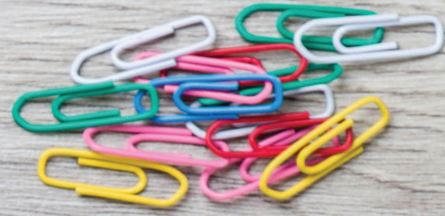
CREDIT BIDDING IS ON THE LEVEL

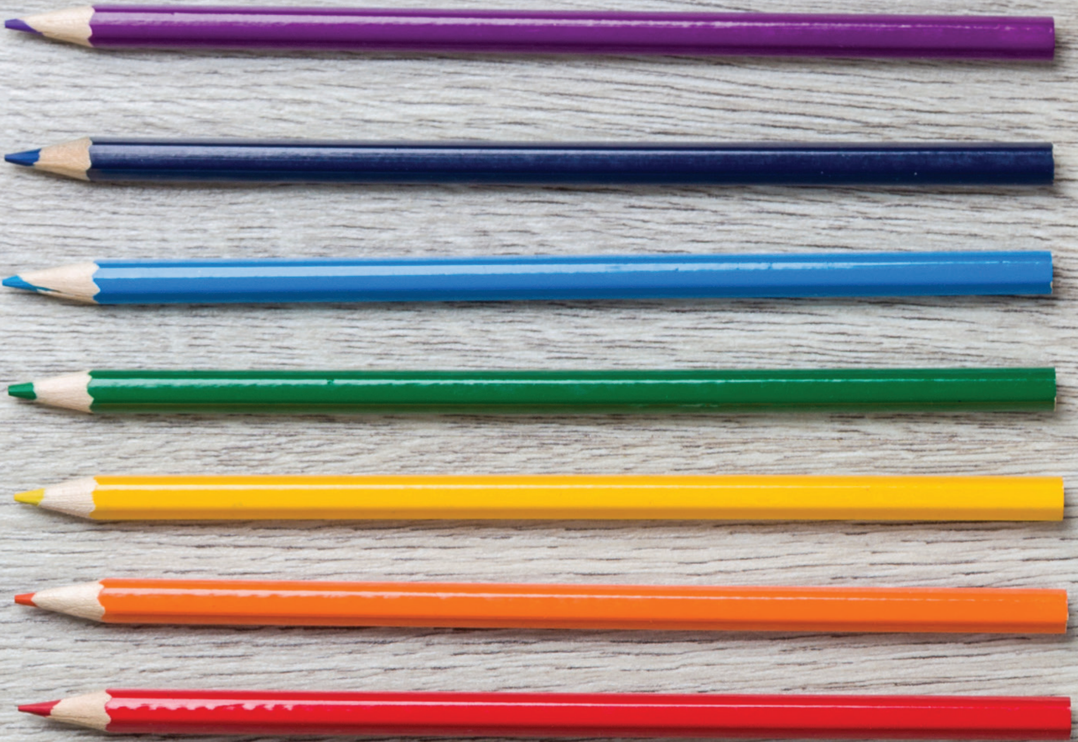
Credit bidding. It's a perpetual issue, especially in the Third Circuit, and in the commercial real estate loan context, generally. Last year, we reported on *In re Fisker Automotive Holdings, Inc.*, a case that "sent shock waves through the distressed debt market," said Holman. *Fisker* seemed to limit the right of a secured creditor to credit bid, a tool secured parties used to protect their interests in the value of their collateral. But not much has actually changed. "Since the decision, we've all sort of calmed down," Holman said. The specific facts in *Fisker* may have limited its reach.

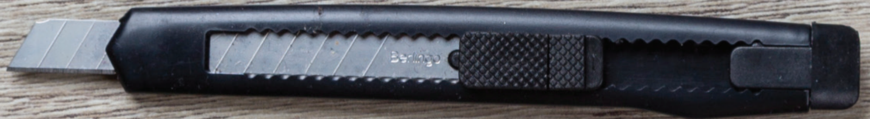
The American Bankruptcy Institute's Commission to Study the Reform of Chapter 11, which we will discuss more on page 13, looked at whether credit bidding should even be advisable in chapter 11 cases, since those credit bids could chill the auction process. But the potential chill to other bids isn't reason enough for courts to prevent it, the commission decided.

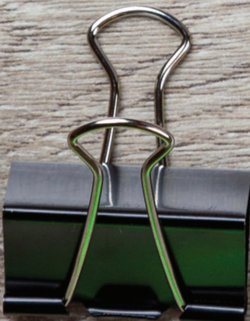
Our panel agreed. In *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, the U.S. Supreme Court reinforced the idea that a secured creditor cannot be denied this protection. "If the mere fact that a well-secured creditor can credit bid up to the amount of its debt chills the bidding, so be it," explained Holman. "It shouldn't be something that the court can in any way reduce for that reason alone."

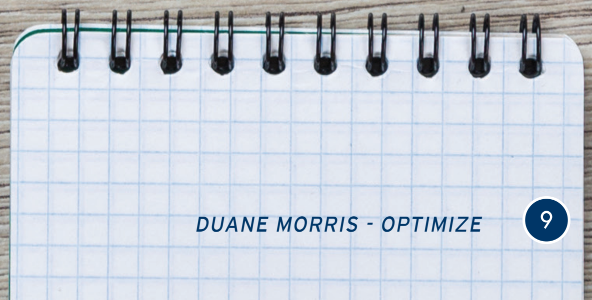
> Think of it like your wish list; throw everything in there that you could possibly ever want out of the receivership.









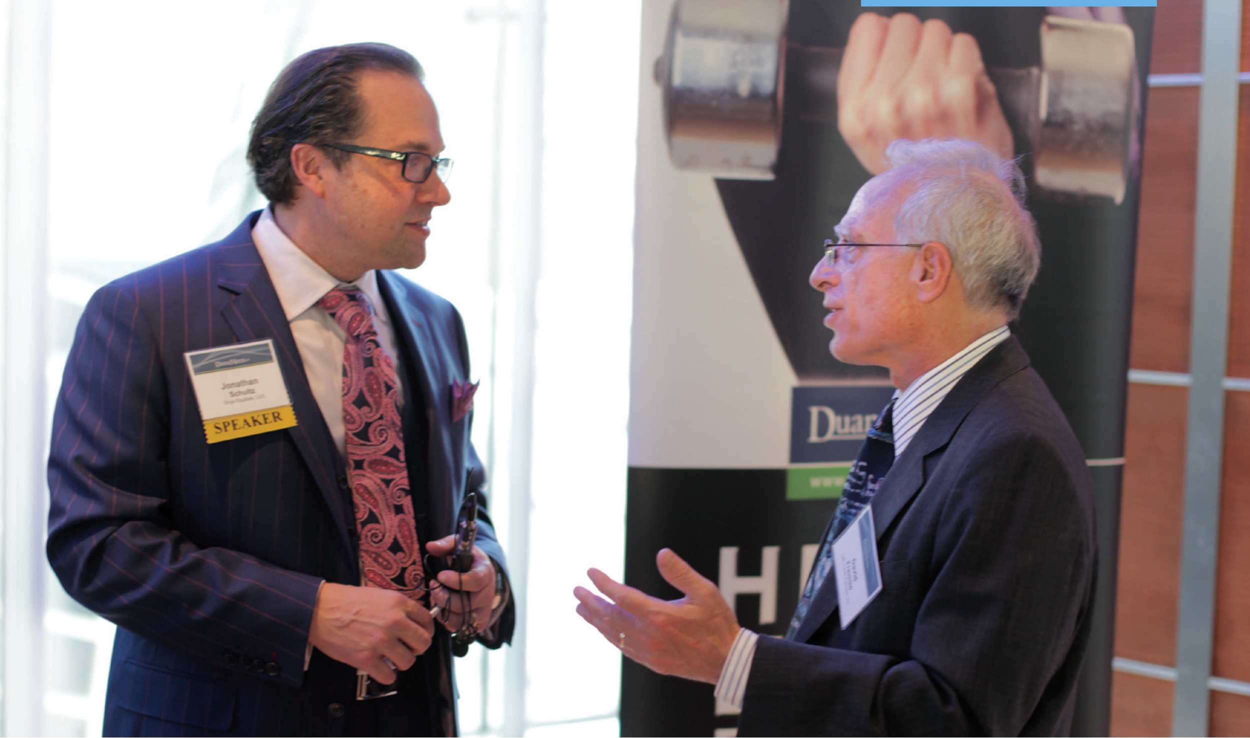


THE 363 SALE, POWER DRILL OF THE CHAPTER 11

Another important tool is the Section 363 sale. In *LCI Holding*, the Third Circuit gave the debtor, an owner of long-term acute care hospitals, the flexibility to use Section 363 sales or settlements outside of the plan context. In *LCI*, a purchase agreement provided for the secured creditors to allocate payment for the debtor's legal and accounting fees to move the deal forward. The secured creditor effectively funded the administrative expenses in the bankruptcy.

Because it had allocated funds under a separate escrow agreement, isolated from the actual credit bid proceeds, the court allowed this. Holman noted: "This is a tremendous workaround of what would otherwise be a very complicated, very expensive chapter 11 confirmation plan process. A variety of parties managed to settle their respective interests without having to confirm a plan."

From left: Onyx Equities, LLC's Jonathan Schultz contributes further perspective on trends impacting key industries.



INDUSTRY SNAPSHOTS

COMMERCIAL REAL ESTATE

"Things have improved somewhat in the commercial mortgage-backed securities (CMBS) market in the past year," said Taylor, despite interest rate hikes and regulatory uncertainty. Last summer, delinquency rates of CMBS loans reached their lowest level in the past six years. But there are still plenty of distressed commercial real estate loans out there, CMBS and non-CMBS alike, said Onyx Equities' Jonathan Schultz. Lenders use the foreclosure process and the receivership process as alternative remedies to limit the costs and the unpredictability that can come with bankruptcy. Challenges to chain of title plague CMBS lenders because there are usually multiple transfers of the underlying loan documents. Borrowers continue to use these chain of title challenges to try to "stave off foreclosure on their assets," said Schultz.

The most significant development in the CMBS market by far, however, is the looming avalanche of maturities coming due in the years ahead. What has seemed to be a calm, steady and efficient structure for commercial real estate may be headed for trouble.

OIL AND GAS

Of course, the oil and gas sector saw a significant depression in pricing. "As we predicted last year, the highly levered industry put pressure on liquidity and on the credit agreements," noted Chadwick. There's been approximately 20 bankruptcies in the exploration and production (E&P) space over the last 12 months. The pricing pressure continues to be significant. Defaults are increasing, and the credit market is tightening. The second lien market is completely shut off. And we have not seen the worst of the financial

performance of E&P companies over the last year. With their borrowing base constricted, they cannot access the high-yield market.

Traditional lenders take a more conservative approach to their exposure to the oil and gas space. Even companies with very good underlying assets produce at a loss, their liquidity drying up. Significant maturities in the bonds are coming due. "They are very ripe for bankruptcy," said Chadwick. "And, ultimately, potentially credit bidding."

MINING AND COAL

Mining companies face reduced demand and a lack of financing. Bankruptcies and credit bidding in coal will continue. Metallurgical coal will not rebound in the near term. "We see continued depression in metallurgical and in thermal coal prices," said Chadwick.

Similar to oil and gas, mining and coal entities have very complicated capital structures. They also have significant legacy liabilities. "You will likely see several more bankruptcies in the near term, including from those companies that are currently attempting to restructure outside of a filing," added Chadwick.

HEALTHCARE

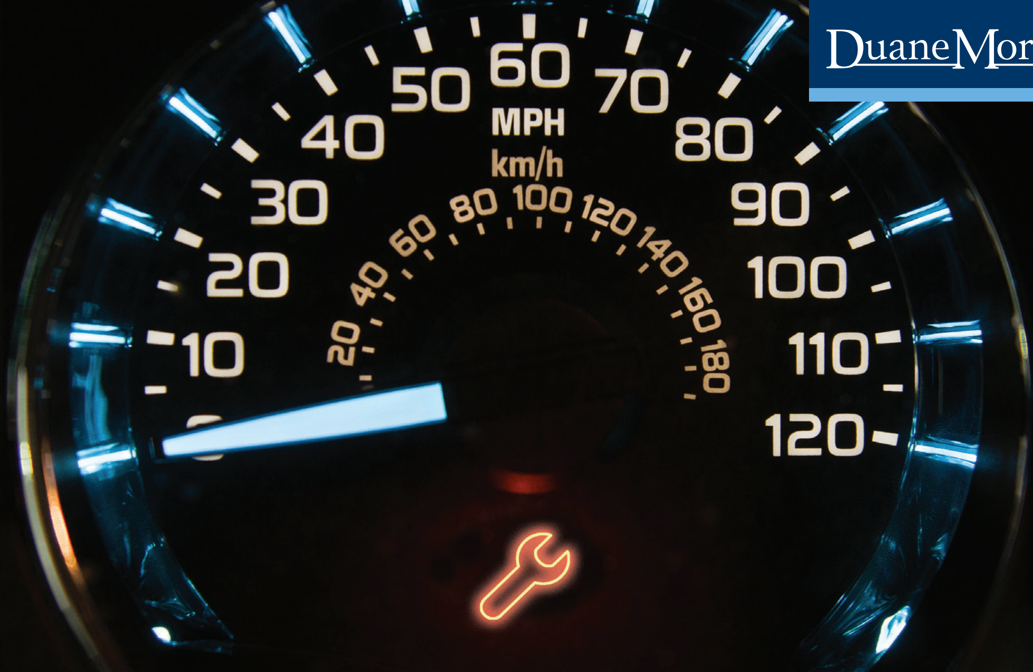
Significant regulatory changes, technological innovations, financial pressures and market dynamics in the healthcare industry are propelling consolidation. Market-dominant players—the big providers—are taking over.

The healthcare industry, which hasn't had an economic restructuring in decades, has suffered some collateral damage as a result of Obamacare, said Chadwick. "When we stepped in as chief restructuring officers for hospitals, we were always very worried about occupancy rates. That's been flipped on its head. You're now motivated by the outcome." Providers are rewarded for keeping costs low.

But many providers are not able to leverage themselves to reduce their costs. They do not have the internal systems to bill appropriately. Not only are they now getting paid less for the services they provide, but they are also getting paid less frequently.

Look for considerable integration and consolidation for healthcare service providers over the next several years.

Lauren Lonergan Taylor, now at TD Bank, listens attentively in an exchange of views on the state of the Bankruptcy Code.



A WRENCH IN THE CODE

Clearly, the Bankruptcy Code has some rough edges in need of repair. It has not been amended since 2005, and it has not been overhauled since 1978. Legislative change does not seem imminent. In 2014, the ABI commission submitted its long-awaited report to Congress on proposed revisions. So far, all is quiet on making change.

Duane Morris senior associate Kate Heitzenrater noted the following recommendations from the 370-page report:

- A single standard to determine adequate protection under Section 361. Courts currently use different standards to measure the value of a secured creditor's collateral.
- Narrowing the use of Section 506(c). This allows the debtor to surcharge a secured creditor's collateral; the trustee can recover from the collateral the necessary expenses of preserving or disposing of that collateral. 506(c) should not be used to cover the administrative costs of operating an estate. Trustees should not be allowed to waive their Section 506(c) claims, which can benefit the entire estate.
- Restricting the use of debtor-in-possession (DIP) financing credit roll-ups, used by debtors to avoid a priming fight or costly evaluation litigation. DIP roll-ups should be approved only where the post-petition facility is provided by lenders who are not related to the pre-petition lenders. If the lenders are related, the post-petition facility must repay the pre-petition facility in cash. Otherwise, it is essentially a refinancing of the pre-petition debt on better terms to the secured lender.
- Courts are split on the releases and exculpation provisions used in reorganization plans. Exculpation provisions provide limited immunity for debtors and their professionals during a chapter 11 case. That immunity should apply to the conduct of the estate representatives in a case of simple negligence, but not necessarily gross negligence

or willful conduct. Consensual releases, which bar creditors from pursuing claims against other entities, should be adequately disclosed in the debtor's plan and disclosure statement. Specific factors should be used to determine whether a third-party non-consensual release is appropriate.

Like economic factors and other things beyond our control, bankruptcy professionals should not wait for policy changes to clarify tough problems.

"Unless our legislatures come up with some wonderful solutions ahead, I think we're going to have to deal with these issues with the tools that we've got," Heitzenrater noted.

Not to mention old-fashioned elbow grease.

"Unless our legislatures come up with some wonderful solutions ahead, I think we're going to have to deal with these issues with the tools that we've got."

Our panelists and moderator provided key takeaways at our program, which focused on how business can find an edge in an increasingly competitive market by applying the right tools of the trade. From left: Peter Chadwick of Berkeley Research Group; Lauren Lonergan Taylor of TD Bank and a Duane Morris alum; James Holman and Catherine Beideman Heitzenrater of Duane Morris; and Jonathan Schultz of Onyx Equities, LLC.

SPEAKER PROFILES

MODERATOR

JAMES J. HOLMAN is a partner at Duane Morris LLP. Mr. Holman practices in the areas of commercial finance law, business reorganization, business and municipal insolvency, and complex asset planning. He represents institutional lenders, trust companies, insurance companies and businesses in a broad spectrum of transactions, including corporate finance, asset sales and planning structures, business restructuring and bankruptcy. He also provides advice on matters affecting wealth and asset planning for high net worth individuals.

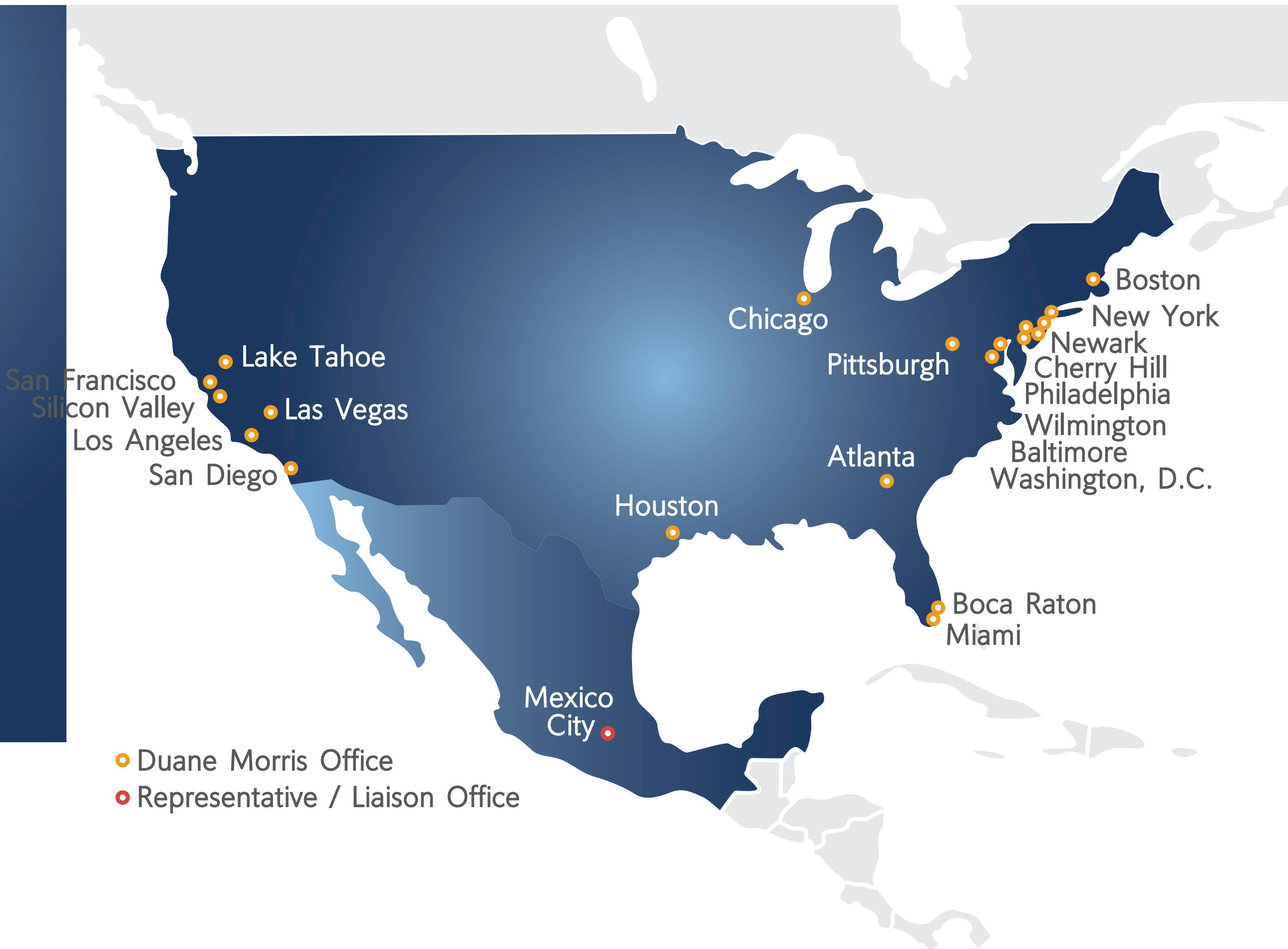
PANELISTS

LAUREN LONERGAN TAYLOR recently joined TD Bank, N.A., as Senior Vice President, Director and Managing Counsel, Head of Commercial Lending, after a more than 20-year career at Duane Morris. While a partner at Duane Morris, Ms. Taylor practiced in the areas of commercial finance, secured transactions, business reorganization, financial restructuring, creditors' rights and bankruptcy law. She represented numerous commercial banks, insurance companies, non-institutional lenders and borrowers in secured lending, asset-based lending, leasing and credit enhancement transactions and other types of commercial transactions. She assisted both creditors and borrowers in complex workout, restructuring and insolvency matters, including in connection with the enforcement of remedies through commercial litigation in federal and state courts.

CATHERINE BEIDEMAN HEITZENRATER is a senior associate at Duane Morris LLP. Ms. Heitzenrater practices in the areas of bankruptcy, corporate reorganization, creditors' rights, commercial finance and secured transactions. She represents chapter 11 debtors-in-possession, chapter 11 trustees, chapter 7 trustees, liquidating trustees, creditors' committees, insurance companies and secured creditors in all aspects of a bankruptcy case. She has assisted creditors in enforcement of remedies through commercial litigation in federal and state courts.

PETER CHADWICK is managing director of Berkeley Research Group. He helps underperforming businesses and advises debtors and creditors in complex restructuring matters. He has served as chief restructuring officer, chief executive officer, chief operating officer, chief financial officer and advisor to companies in a variety of industries. Chadwick has led restructurings in manufacturing, production and construction, including renegotiating contracts with original equipment manufacturers and creditors, effectuating sale transactions and preparing business plans.

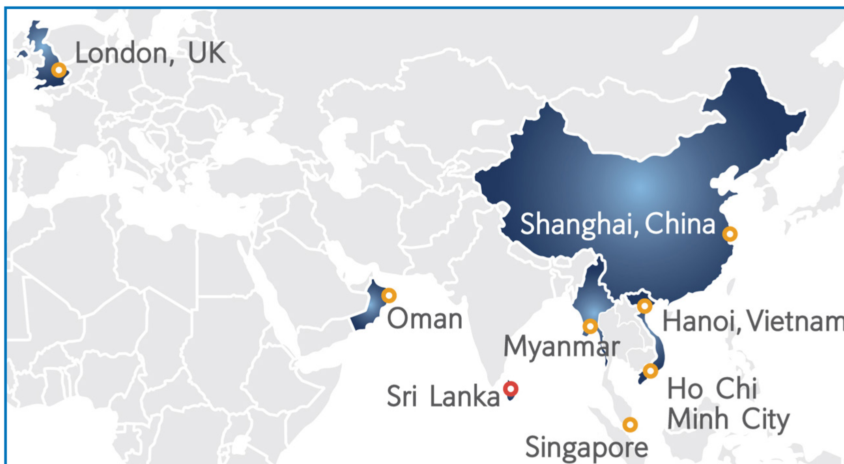
JONATHAN SCHULTZ is co-founder and managing principal of Onyx Equities, LLC. He oversees the organization's investor capital raising initiatives, strategic planning, portfolio management and business development, as well as formulating overall investment strategy. He has initiated and closed billions of dollars in leasing and commercial real estate sales and acquisitions.


Boston
New York
Newark
Cherry Hill
Philadelphia
Wilmington
Baltimore
Washington, D.C.
Chicago
Pittsburgh
Lake Tahoe
San Francisco
Silicon Valley
Las Vegas
Los Angeles
San Diego
Atlanta
Houston
Boca Raton
Miami
Mexico City
Duane Morris Office
Representative / Liaison Office

ABOUT DUANE MORRIS

With experienced bankruptcy and restructuring lawyers across our domestic and global platform, coupled with the deep capabilities of more than 750 lawyers across all practice areas, Duane Morris offers the resources to optimize our clients' interests. From creditor to debtor, and trustee to committee, our bankruptcy practice is regularly recognized as one of the most active for both case volume and value of liabilities. We leverage our core experience in bankruptcy law, creditors' rights and asset recovery actions and the full range of services for commercial mortgages and other asset classes, working with banks, non-bank lenders, special servicers, debt purchasers and asset buyers.

On the distressed deal side, our lawyers have negotiated and brokered major transactions in such industries as manufacturing, real estate, telecommunications and retail. Five of the practice group's former attorneys are sitting United States Bankruptcy Court judges, and another is a judge on the United States Court of Appeals for the Third Circuit.



Duane Morris – Firm and Affiliate Offices | New York | London | Singapore | Philadelphia | Chicago | Washington, D.C. | San Francisco Silicon Valley | San Diego | Shanghai | Boston | Houston | Los Angeles | Hanoi | Ho Chi Minh City | Atlanta | Baltimore | Wilmington | Miami Boca Raton | Pittsburgh | Newark | Las Vegas | Cherry Hill | Lake Tahoe | Myanmar | Oman | Duane Morris LLP – A Delaware limited liability partnership

This publication is for general information and does not include full legal analysis of the matters presented. It should not be construed or relied upon as legal advice or legal opinion on any specific facts or circumstances. The invitation to contact the attorneys in our firm is not a solicitation to provide professional services and should not be construed as a statement as to any availability to perform legal services in any jurisdiction in which such attorney is not permitted to practice. © Duane Morris LLP 2016.