A Snapshot of the Polaroid Sale and Certain Considerations in 363 Sales

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In May 2009, following what has been billed by some as one of the longest auctions in the history of Section 363 of the Bankruptcy Code, Polaroid was sold to a consortium consisting of Hilco Consumer Capital and Gordon Brothers Group in a transaction valued at approximately $87.6 million—more than twice the $42 million the stalking horse bidder had agreed to pay in an agreement entered into in January 2009. The sale was the culmination of an extremely competitive sale process that began in December 2008, when the company and certain of its subsidiaries filed for bankruptcy. In connection with the sale, Polaroid's creditors acquired a 25% ownership interest in the entity that now owns the iconic brand. Lindquist & Vennum represented Polaroid on the transaction.

The three-week auction

The twists and turns of the Polaroid auction process were widely reported in a variety of mainstream publications, including The Wall Street Journal and the Star Tribune, as well as leading industry publications such as The Daily Deal and Debtwire. The auction began at Lindquist & Vennum's offices on March 30 and 31. At this time, it was determined that bidders would be permitted to bid with equity in the buyer entity, but that the amount of such equity would be capped at a 20% ownership interest. Following this auction, Patriarch Partners was declared the winning bidder, with a price of approximately $59.1 million. Hilco/Gordon Brothers objected to a sale to Patriarch at that price, saying that they were prepared to offer equity in excess of the 20% cap, and that the cap deprived creditors of significant value that could be realized based on the buyer's future success. At a sale hearing held on April 6, Judge Gregory F. Kishel upheld the 20% equity cap, but agreed to allow both Patriarch and Hilco/Gordon Brothers to submit one final sealed bid, to be submitted no later than 4:00 p.m. on April 7. Following the submission of these sealed bids, Hilco/Gordon Brothers emerged as the victor, with a bid of approximately $72.6 million. Prior to the sale hearing on the morning of April 9, however, Patriarch submitted yet another bid of approximately $75.5 million.

With the continued bidding generating additional value for the benefit of creditors, Judge Kishel reopened the auction for a final round of bidding in his courtroom on April 16—this time, at the request of several constituents, with a 25% equity cap. On this day, following the back and forth of 28 competing bids that spanned nearly nine hours, Patriarch appeared to have won with a bid of

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$88.1 million. The difference between the final bids—approximately $500,000—was not enough to sway Polaroid's creditors, however, who believed the Hilco/Gordon Brothers bid to be the highest and best offer, in large part because of the consortium's success in operating other brands purchased out of bankruptcy. Based on the creditors' collective view, Judge Kishel approved the sale to Hilco/Gordon Brothers at a price of approximately $87.6 million.

Increasingly popular M&A forum; certain considerations in 363 sales

The sale of Polaroid through a 363 sale process is just one example of what is occurring with increasing frequency these days. Many companies are struggling in these challenging economic times, and distressed acquisitions have comprised a significant portion of M&A activity over the last 12 months. Moreover, 2009 has seen an increasing number of 363 sales. In April, The Wall Street Journal reported that 67 such transactions had been completed to date in 2009. According to investment banker Stephen Spencer at Houlihan Lokey, the financial advisor to Polaroid on the transaction, "the robust market in so-called distressed mergers and acquisitions, or 'DM&A' deals, is a natural consequence of excessive middle-market leverage and increased buyer interest in acquiring distressed assets." Commenting further on the current M&A environment, Spencer noted "[t]here are a number of smart buyers who watched middle-market leverage metrics increase from approximately 3.5 times cash flow in 2001 to over 5.5 times in 2007, and realized that the unsustainable leverage profiles of otherwise valuable companies would create tremendous buying opportunities in bankruptcy-related auction processes."

Companies experiencing financial strain should work closely with their legal and financial advisors and carefully consider all available options. In some cases, a bankruptcy filing may not be the best or only option, but if it is, a 363 sale can be a good way to maximize value. Companies considering such a process should evaluate not only the advantages and disadvantages of a 363 sale, but also keep in mind that a number of factors will come into play in determining whether a 363 sale is even viable for a particular company.

Is pursuing a 363 sale a sensible course of action?

Whether a 363 sale is a viable alternative will depend on a variety of factors, and the considerations will, necessarily, be tailored to the particular company's industry and situation. The following are some key considerations that apply in many instances:

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- ***Purchasers.*** Companies and their advisors should evaluate the spectrum of potential buyers and the interest a sale transaction may generate. In the Polaroid transaction, Houlihan Lokey approached more than 200 interested acquirers, which required extensive dialogue to educate a number of legitimate prospects that were otherwise unfamiliar with the 363 sale process.
- ***Possibility of consensual restructuring.*** Companies may want to consider whether a consensual restructuring is possible. In this regard, companies should bear in mind that debtor-in-possession financing is difficult to obtain, especially in the current lending environment.
- ***Cash flow.*** Companies will need visibility on their anticipated future cash flow as they consider whether they can sustain themselves through the sale process.
- ***Strategic value.*** Consideration should be given to whether the business possesses real strategic value. For example, does the business have any assets that convey unique value (e.g., an iconic brand name like "Polaroid")?
- ***Nature of liabilities.*** The extent and nature of liabilities to which the business is subject may increase or decrease the likelihood of a successful sale process.

Advantages of a 363 sale

- ***Freedom from liens and claims.*** A key benefit of a 363 sale is that the purchaser acquires the assets free and clear of liens, claims, and interests.
- ***Competitive tension.*** A competitive process can be used to maximize value. The overarching goal of a 363 sale is to find the highest and best offer. The sale of Polaroid—where the final sale price exceeded the stalking horse bid by nearly 110%—is a textbook example of the value competitive tension can provide.
- ***Limited successor liability.*** Deals outside of bankruptcy carry greater risks for successor liability under bulk sales laws and various successor liability doctrines (e.g., de facto merger, continuity of enterprise, etc.). Similarly, a purchaser of assets of a financially distressed company outside of bankruptcy may be subject to an increased likelihood of fraudulent transfer claims.
- ***Assignment of executory contracts.*** Subject to certain limitations, executory contracts may be assigned to a purchaser notwithstanding provisions in such contracts that prohibit assignment without prior written consent.
- ***Ability to "cherry pick" assets.*** The purchaser may select the assets that it wants to acquire and obtain an order of the bankruptcy court that such assets are free and clear of all liens and encumbrances.

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- ***Binding non-consenting constituencies.*** State law generally requires shareholder approval in connection with a sale of substantially all of the assets of a company. These state law requirements are moot in a 363 sale.

Disadvantages of a 363 sale

- ***Stalking horse may not be the one.*** As in the case of Polaroid, the stalking horse may not ultimately be the successful bidder. The debtor may have a substantial "get to know you" period with the stalking horse, but may not have that opportunity with another bidder who emerges as the victor at auction. Further, the strategy and goals of the successful bidder may not align with those of the stalking horse, causing management and legal and financial advisors to consider additional or different issues that may not have been foreseeable throughout the process.
- ***Heightened scrutiny.*** A 363 sale is subject to notice and hearing and, ultimately, bankruptcy court approval. Creditors and other interested parties have the right to be heard and object.
- ***Publicity.*** Bankruptcy sales are public proceedings. Especially in a high-profile cases such as Polaroid, the media is likely to closely follow proceedings. Such media coverage can be disruptive to ongoing operations and affect employee morale.
- ***Timing and costs.*** A sale in bankruptcy is a process. Outside of bankruptcy, a sale can often be accomplished more quickly and at less cost than a sale in bankruptcy.

A 363 sale represents the intersection of bankruptcy and M&A and requires legal counsel with significant experience in both disciplines. The factors noted above are just some of the considerations a financially distressed company should keep in mind as it considers whether a 363 sale is the right move. Of course, no two transactions are the same, and companies should work closely with their legal and financial advisors to develop a complete list of principal considerations and carefully evaluate all available options. ■

George Singer focuses his practice on corporate and commercial law, particularly bankruptcy, distressed sales, and business reorganization. View a complete biography at www.lindquist.com/gsinger

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