

COVID-19 Coronavirus Business Impact Broadcast Series

Section 363 Sales and Reps & Warranties Insurance: Opportunities and Risks during COVID-19

MAY 29, 2020

On May 29, 2020, Dechert's Private Equity group, together with Euclid Transactional, presented "Section 363 Sales and Reps & Warranties Insurance: Opportunities and Risks during COVID-19," an episode of the firm's COVID-19 Coronavirus Business Impact Broadcast Series. The episode was hosted by Steve Pratt (moderator), an M&A partner in the firm's Philadelphia office; Shmuel Vasser, a restructuring partner in the firm's New York office; and Jay Rittberg, the managing principal of Euclid Transactional, a leading representations and warranties insurance underwriter.

The presenters provided an overview of the benefits and risks associated with sales under section 363 of the U.S. Bankruptcy Code, and discussed some of the options available to purchasers for mitigating those risks with representations and warranties insurance (R&W insurance) and other insurance products.

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HIGHLIGHTS FROM THE EPISODE

363 Sale Overview and Process

Rather than pursuing a traditional Chapter 11 bankruptcy plan, many distressed companies choose to initiate a sale of all or some of the debtor's assets under section 363 of the U.S. Bankruptcy Code. Purchasers in a 363 sale benefit because they are able to buy the debtor's assets free and clear of all claims, interests and encumbrances, which only attach to the proceeds of the sale, not the assets themselves. A debtor may initiate a 363 sale prior to filing for bankruptcy by negotiating a purchase agreement with a "stalking horse bidder" who is afforded deal protections such as a break-up fee, expense reimbursement, and conditioning the binding nature of the purchase agreement on milestones set for the debtor. After the winning bidder is chosen (usually the stalking horse), the debtor seeks the bankruptcy court's approval for the sale.

Benefits and Risks of 363 Sales

363 sales are faster and more streamlined than Chapter 11 restructurings and allow bidders to acquire only the assets or contracts that they choose. Purchasers are also able to acquire the assets free and clear of liens and other interests and are insulated from fraudulent transfer and successor liability concerns. However, the sale is subject to the bankruptcy court's approval and is conducted on full public display, subjecting the stalking horse to the risk of being outbid. Unsecured creditors may also attempt to interfere with the process by seeking additional marketing or by challenging previously approved bid protections. For purchasers, the transfer of assets may incur different taxation consequences than in a Chapter 11 plan, and successor liability risks are not entirely eliminated. As well, there is typically no recourse under the purchase agreement for representations and warranties beyond any negotiated reserve, which is uncommon in most 363 sales.

Mitigation of 363 Sale Risk with R&W Insurance

Purchasers can use traditional R&W insurance to obtain post-closing protection, particularly where the representations and warranties under the asset purchase agreement do not survive the closing. This protection can be enhanced if the underwriter agrees to synthetically remove materiality and MAE qualifiers, as is typical in other "nonseller recourse" transactions. While underwriters typically do not offer "synthetic" coverage for representations and warranties that are not included in the purchase agreement, the market may evolve to offer such products, in particular for matters supported by third party reports and/or adequate due diligence.

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