Wednesday, May 8, 2013 at 9:15 a.m.

On Sale Now – Distressed Assets of US-Based Technology Firms are on the Auction Block and Asian Firms are Buying

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Section 363(f) of the US Bankruptcy Code

Section 363(f) of the US Bankruptcy Code has long been recognized as a powerful tool for acquiring assets free and clear of all liens, claims, and encumbrances and often at prices below what would be considered "market."

Section 363(f) of the US Bankruptcy Code

This statute provides that a trustee in bankruptcy or a debtor in possession may sell property of the debtor "free and clear of any interest in such property of an entity" if:

1. applicable non-bankruptcy law permits sale of such property free and clear of such interest;
2. such entity consents;
3. such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
4. such interest is in bona fide dispute; or
5. such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

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A trustee or debtor in possession may also sell property owned jointly by the debtor and another co-owner in this same way, if certain additional conditions are satisfied. *See* 11 U.S.C. §363(h).

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Assets and entire going concern enterprises can also be transferred as part of a plan of reorganization if a debtor can meet all of the requirements of Section 1129 of the Bankruptcy Code. This process tends to be more cumbersome and time consuming than a sale under Section 363.

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- Section 363 sales and plans of reorganization have been used to procure the highest and best price for valuable assets owned by an otherwise distressed company in order to maximize the value of those assets to a company's creditors.
- In certain circumstances, Section 1146 of the Bankruptcy Code can be used to reduce or eliminate the tax consequences of certain transfers.

A variety of international companies have utilized the US bankruptcy process to capitalize on opportunities to acquire business assets in the US through unconventional means.

Moltech Power Systems, Inc. – 363 Sale

- Moltech manufactured rechargeable nickel cadmium and nickel metal hydride cells for incorporation into battery packs.
- Moltech's assembly of the battery packs occurred in its manufacturing plant in Alachua, Florida. It also conducted business through subsidiaries located in Mexico, the United Kingdom, Hong Kong, France, Germany, Sweden, and Malaysia.

Moltech Power Systems, Inc. – 363 Sale

- As a result of a cancellation in orders from its largest customer, Moltech cut its workforce down to approximately 800 employees, down from more than 2,300.
- Moltech filed a voluntary Chapter 11 petition on May 22, 2001, at which time it listed approximately $70 million in assets and approximately $80 million in liabilities.

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Moltech Power Systems, Inc. – 363 Sale

- After filing its petition, Moltech sought to sell certain of its assets pursuant to Section 363:
  - machinery, equipment, tools, vehicles and other tangible personal property
  - equipment owned by a subsidiary of the Debtor based in the United Kingdom (the "UK Subsidiary")
  - trademarks, trade names, copyrights, patents, patent applications, trade secrets and related intellectual property owned by the Debtor and the UK Subsidiary.

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Moltech Power Systems, Inc. – 363 Sale

- Proposed purchaser of Moltech's assets was Shanghai Huayi (Group) Company, an entity controlled by the government of Shanghai, China.
- Purchase price was $5.6 million.
- As part of the agreement to purchase, Moltech agreed to supply certain raw materials to Shanghai Huayi for the aggregate purchase price of $14.32 million, and provided that Moltech would lease certain property to Shanghai Huayi.

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<u>Moltech Power Systems, Inc</u>. – 363 Sale

- While its offer was subject to higher and better offers, Shanghai Huayi succeeded in obtaining the assets and the sale was subsequently approved by the Bankruptcy Court.

<u>The Connaught Group, Ltd</u>. – 363 Sale

- The Connaught Group, Ltd. and its affiliates comprised the largest direct seller of high-end women's clothing in the United States, maintaining a network of more than 1,300 independent sales consultants that provided personalized wardrobe consultations to professional and social women.

<u>The Connaught Group, Ltd</u>. – 363 Sale

- Connaught's revenues dropped from over $150 million in 2007 to approximately $108 million in 2010.
- As a result, Connaught implemented several restructuring initiatives.
- The efforts were insufficient and Connaught eventually filed Chapter 11 petitions on February 9, 2012.

<u>The Connaught Group, Ltd</u>. – 363 Sale

- At the time of filing, Connaught had outstanding secured obligations in excess of $12 million and approximately $48 million in unsecured debt.

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<u>The Connaught Group, Ltd</u>. – 363 Sale

- On February 24, 2012, Connaught filed a motion pursuant to Section 363 asking the Court to enter an order permitting it to sell its assets in whole to a single bidder or in part to multiple bidders.
- Assets included intellectual property and tangible assets.

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<u>The Connaught Group, Ltd</u>. – 363 Sale

- Royal Spirit Group Ltd. ("RSG") was a Hong Kong-based apparel supplier and one of Connaught's largest manufacturers.
- RSG also asserted several claims against Connaught, including claims for reclamation, administrative claims, and a large general unsecured claim.

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The Connaught Group, Ltd. – 363 Sale

- RSG partnered with Tom James Co., a Tennessee-based manufacturer and retailer of custom men's clothes and made a $20 million bid for Connaught's assets.
- The RSG/Tom James offer was determined to be the "highest and best bid" because all other competing bids would result in a liquidation of Connaught's assets and most of its employees being laid off.
- RSG also agreed to waive its unsecured claim, allowing the remaining unsecured creditors a greater recovery.
- An order approving the sale to RSG/Tom James was entered on April 13, 2012

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Jennifer Convertibles, Inc. – Sale of Equity Through Plan of Reorganization

- Jennifer Convertibles, Inc. operated over 130 furniture stores throughout the United States under the "Jennifer Convertibles" and "Ashley Furniture HomeStore" brands. Jennifer Convertibles specialized in sofabeds, while Ashley Furniture operated full line furniture stores.

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Jennifer Convertibles, Inc. – Sale of Equity Through Plan of Reorganization

- Jennifer's consolidated financial statements for the fiscal year ending August 29, 2009 showed net sales from continuing operations of approximately $89 million, down over 21 percent from the prior year.
- Jennifer eventually filed Chapter 11 petitions on July 18, 2010 in the U.S. Bankruptcy Court for the Southern District of New York.

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<u>Jennifer Convertibles, Inc</u>. – Sale of Equity Through Plan of Reorganization

- At the time of filing, Jennifer did not have any secured creditors, but had almost $35 million in unsecured debt.
- Jennifer's Chinese furniture supplier, Haining Mengnu Group Company Ltd. ("Mengnu"), was owed more than $17 million of this amount.

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<u>Jennifer Convertibles, Inc</u>. – Sale of Equity Through Plan of Reorganization

- Jennifer sold certain of its inventory and other assets via a motion under Section 363 of the Bankruptcy Code
- It then confirmed a plan in which Mengnu's unsecured claim in the amount of $14,878,760.45 was exchanged for 90.1% of the common stock of the reorganized debtors.

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Other more recent and ongoing bankruptcy cases

- Satcon Technology Corporation – Use of Priming Lien to Acquire Assets.
- A123 Systems, Inc. – 363 Sale.

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Potential Regulatory Issues

- Review by the Committee on Foreign Investment in the United States ("CFIUS").
- CFIUS: an inter-agency committee run by the US Secretary of the Treasury authorized to review transactions that could result in control of a US business by a foreign person in order to determine the effect of such transactions on the national security of the United States.

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Potential Regulatory Issues

If CFIUS finds:

- a covered transaction presents national security risks and
- other provisions of law do not provide adequate authority to address the risks

Then CFIUS may:

- enter into an agreement with, or impose conditions on, parties to mitigate such risks or
- refer the case to the President for action

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Questions

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