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Throwing a Lifeline

How to acquire troubled assets using a lawyer's toolbox.

The current economic difficulties in the United States generally are associated with job losses and business failures, along with the associated increase in individual and business bankruptcy filings. However, difficult economic times also present opportunities for strong businesses to make strategic acquisitions of troubled assets and businesses at good prices to expand their market share or acquire a synergistic business line to augment their current business models. This particular economic down cycle may also provide some unique opportunities involving financial institutions that wish to shed assets quickly before the loss of the going concern value of their customers (i.e., before the bank's foreclosure of the assets). Recent anecdotal information suggests that this type of merger and acquisition (M&A) activity in the Northwest is just beginning as buyers perceive that the bottom of the economic downturn is at hand.

When such strategic opportunities become available, it is important that the acquiring company involve not only its business and M&A attorneys, but also bankruptcy and restructuring professionals to ensure an efficient process with maximum protection for the acquiring company. The use of the traditional purchase and sale

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agreement and lien releases to ensure free and clear title to a purchaser usually does not work well when the target is in distress. Creditors with liens, including judgment lienholders, often refuse to execute lien releases or use the threat of litigation to leverage payment beyond their actual economic stake in the assets being sold. Insolvency and restructuring professionals have numerous tools available in their arsenal to achieve a successful acquisition of a troubled business or assets.

First, receiverships or assignments for the benefit of creditors ("ABCs") provide the means to preserve the going concern value of a business while a sale of the business or assets is being procured by the receiver. In Washington, receiverships and ABCs are now both structured under the 2004 Washington Receivership Statute that provides for many bankruptcy-like provisions including an automatic

stay to preserve assets against attaching and foreclosing creditors and a provision for sales of assets free and clear of liens on notice to creditors. Lane Powell commenced the first receivership on behalf of a secured lender under this statute, and the receiver and his counsel were successful in identifying three possible purchasers and selling the business assets within a relatively short period of time. The key to the success of this business acquisition strategy is to get the right receiver for the situation.

Second, bankruptcy sales provide another method to acquire a business free and clear of liens, including sales of ongoing businesses under Chapter 11. While there needs to be a legitimate business reason to sell assets outside of a Chapter 11 plan, the loss of going concern value often provides a sufficient reason to use the sale process instead of the Chapter 11 plan process. For example, such Chapter 11 sales were common during the dot-com liquidations in the 1990s. The recent Chrysler and GM Chapter 11 cases illustrate that size is not an obstacle to using a sale instead of a Chapter 11 plan. Bankruptcy also provides a means to assume leases that are in default, so long as the defaults are cured, allowing the purchaser to continue to operate out of the target's key business locations and to preserve the key equipment necessary to ongoing operations.

Finally, in appropriate circumstances, "friendly foreclosures" provide a means to acquire a going concern business. Under this method, the purchaser acquires the position of the first position lienholder (usually the working capital lender), forecloses out junior lien creditors, shuts down the business for a brief period and then reopens following the foreclosure. This type of acquisition generally requires precise lien searches and the cooperation of the target company's management. Given the financial difficulty of many financial institutions, acquisitions of debt at pennies on the dollar may become more common in the near term.

In sum, creative acquisition methods, with the guidance of skilled restructuring professionals, will permit savvy business operators to grow their businesses successfully even in a difficult economy.

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