

November 8, 2011

## Can PE Firms Use Chapter 11 to Credit Bid Away Landlords and Unsecured Debt?

It will be almost Christmas before we know, at least for portfolio companies that can file in the Delaware Bankruptcy Court. The case that will provide guidance is *Friendly Ice Cream Corp.*, where Sun Capital, which is both equity owner and term lender, put Friendly into Chapter 11 on October 5, 2011. It did so after agreeing to a Section 363 purchase agreement with Friendly that would allow a Sun affiliate to buy assets (including desirable lease locations) free and clear by credit bidding outstanding pre-petition term debt owed to Sun.

On November 1, the Delaware Bankruptcy Court approved bidding procedures submitted in connection with the Sun agreement and awarded an affiliate of Sun Capital stalking horse status. The court also approved the \$1,000,000 termination expense reimbursement Sun sought.

That was the good news for Sun. The principal setbacks in the bidding procedures order were that:

- (1) The sale auction date and credit bidding deadline were extended. Competing bidders will now have until December 20 to submit proposals, with an auction being conducted on December 22.
- (2) Sun will see its financing of creditor committee efforts expand significantly, with the DIP carveout going from \$50,000 to \$700,000.

Even with these terms, however, the auction process approved on November 1 by the Bankruptcy Court would appear favorable for Sun, but only to the extent it can credit bid pre-petition debt it holds in addition to the new money DIP financing a Sun affiliate extended to Friendly after filing. The court reserved judgment on this issue until a hearing scheduled for December 15 and 16. The decision from that hearing will determine whether private equity funds can consider a credit bid acquisition in Chapter 11 a viable strategy for rationalizing balance sheets and discarding unfavorable leases and contracts.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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