Baker & McKenzie

Distressed Asset Sales: Protecting Seller Interests

Issues to consider to proceed with confidence

When distressed asset sales are necessary, sellers should be particularly mindful of counter-party risks. Failure to address the risk that a buyer might not be able to complete the transaction can make a difficult situation worse. It is also important to assess the potential for counter-party insolvency and include provisions in sale agreements that protect against the worst.

Issues You Need to Consider

Here are issues sellers should consider when contemplating distressed asset sales not involving formal insolvency proceedings.

Choose bidders carefully. Distressed assets attract many types of bidders, but not all of them have the motivation and financial means to support a turnaround and stabilization of the business. So, take a close look: are the bidders interested in the business as a whole or only selected assets? Does a bidder's business model permit it to support the business, including any assumption of financial exposure from you as the seller? Are they serious and legitimate? Avoid conditional commitments.

Look at the buyer's financing.   If the buyer requires financing, insist on your right to obtain information on the buyer's financing. Specify your rights to terminate the sale if the funding collapses. In certain situations, a reverse break-fee might offer protection.

It's not over with the closing. In many distressed asset transactions, your exposure as a seller may not disappear with the closing. You may remain exposed on guarantees, fiduciary or shareholder liability or avoidance claims in the event of buyer insolvency, regardless of whether the buyer has turned the acquired business around. Given the limited financial investment of most distressed asset investors, an indemnity from the buyer may have limited value. Try to address each risk in the transaction documents.

Be candid with information. If you paint a too bright picture of the distressed business and withhold unfavorable information, the risk of a failed turnaround could revert to you as the seller with potential claims and litigation for breaches of warranties and representations of fraud. Candid and complete information disclosure can lower unrealistic expectations and reduce your risk.

This is one of many ideas on ways to govern, manage, operate and finance your business. If you would like to review additional ideas, visit the Supporting Your Business section on www.bakermckenzie.com. The site is updated regularly, so visit often.

Get equity commitments from SPEs. If signing with a special purpose entity, require some level of equity, and possibly debt, from a financially viable, related entity.

Understand your post-sale obligations. In some jurisdictions, sellers retain certain liabilities even after a sale. It's not uncommon for buyers to use these obligations to demand price concessions post closing. Know the potential size of all your seller exposures and take them into account in pricing the deal.

Protect escrowed funds. In the US, escrow funds might be deemed property of a bankrupt seller's estate unless the escrow agreement contains protections to avoid this outcome.

Our experience and service advantages

Global perspective, commercial pragmatism. Our M&A practitioners bring to distressed asset sales a reliable, pragmatic approach based on experience gained through hundreds of transactions in more than five dozen countries. We can advise with confidence on the issues that buyers are likely to raise and commercially effective strategies to address them in ways that protect asset values and minimize follow-on liabilities.

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