



his corner of *The Secured Lender* invites you to eavesdrop on a conversation taking place between several industry players about a different topic each issue. Pull up a chair and get ready to find out what Bill Brewer, Jon Helfat, Richard Kohn and David Morse had to say about the current commercial finance market from their perspective as practicing commercial finance attorneys.



BRIAN COVE, EDITOR-IN-CHIEF,

THE SECURED LENDER: What impact has the current economic climate and credit environment had on commercial finance attorneys? Is it more challenging to get deals done? Are you spending more time on loans that are in trouble?

WILLIAM BREWER, PARTNER, WINSTON & STRAWN, LLP:

I think it has had a few impacts. One impact is new deals are in many ways easier to get done in the sense that there can be fewer negotiations. More of a return to the center from some of the more pro-borrower ABL provisions, which existed at the height of the larger loan market.

Another impact is that defaults are definitely up and we are busy with restructurings and workouts. Amendments always involve increased pricing now, or at least they seem to, and sometimes are coupled with other improvements in deal terms. The other thing which we're beginning to see, although I wouldn't call it a trend yet, is some ability to either do amendments with extensions or refinancings.

JONATHAN HELFAT, PARTNER, OTTERBOURG, STEINDLER, HOUSTON & ROSEN, P.C.:

Bill, while I certainly agree that the current ABL market is providing lenders with increased pricing and some other improvement in deal terms, I do not, however, believe we are seeing, with the deals that are currently getting closed, the return of the myriad of lender-friendly terms one might have thought would predominate in the type of economy that we have witnessed over the last six months.

BREWER: I've seen some change, Jon. I don't think it's quite as black-and-white as you state that it is. One example I would provide is the ability of agents in their reasonable discretion to address



either reserves or eligibility criteria. We have seen movement on that away from legal provisions containing long, detailed limitations on agents' discretion, more of a return to what we would have seen four or five years ago.

RICHARD KOHN, PRINCIPAL, GOLDBERG KOHN:

Recently there have been situations where lenders are actually competing again for loans, especially in the \$25-50 million range, which is an indication that the market is starting to come back.

As for what we're seeing in the deals, diligence has been more thorough and lengthy. Also, lenders are more aware of adverse actions that have been taken by other lenders in workout situations, and that creates more attention in new deals to voting provisions, anti-layering provisions, rights to remove agents, prohibited assignees and participations, and defaulting lender provisions.

COVE: Now would you say that a greater degree of discipline has returned to the ABL market compared to what it was, say, two, three years ago?

BREWER: I hate the description of a greater degree of discipline. I think what happened was, at the top of the market, the market required certain decisions by agents and lenders in order to win deals. We have seen a renewed ability to address some things that lenders historically have preferred, but maybe were not available at the top of the market. For example, there has been a renewed focus on provisions like the ones Richard Kohn described, such as defaulting lender provisions, voting provisions, permitted assignee provisions and agent provisions.

DAVID MORSE, PARTNER, OTTERBOURG, STEINDLER, HOUSTON & ROSEN, PC: Bill, I think we are also seeing more



attention to such fundamental aspects of an asset-based lender's rights as reserves and eligibility criteria and in general, seeing lenders taking an approach that is more consistent with what was done prior to the bubble of 2006 and 2007 in terms of the rights of lender, including as to such matters as the right to conduct field examinations, receive appraisals, and the frequency of reporting. These are some of the areas where I think we are seeing a return to a more traditional approach and moving away from the risk of the more lax requirements that appeared during the very aggressive times.

KOHN: In the international area, we've seen a focus on shoring up collateral — lenders seeking to strengthen their position on distressed deals in their portfolio by taking liens on additional foreign assets that were not included in the original collateral. Also, I second Bill's comment about restructurings and workouts. During the past year every just-lending lawyer in our office has been working on restructurings, forbearance agreements and the like. And that certainly has been a major difference over prior years.

But I do see that changing as more and more lenders re-enter the market and begin making loans again. Of course, most of the loans we're now seeing are asset-based, as opposed to cash flow, loans. But we are definitely seeing more activity now and I think that's a very good sign.

BREWER: I think Richard's right that we may be beginning to see some thawing, but I think that there are currently, on some of the bigger deals, constraints that didn't exist previously and that really has to do with the breadth and depth of the ABL market. For larger deals, a reduced ability to get things closed, either on a club basis or for the



bigger deals on a syndicated basis. Because there are just not the number of lenders with the willingness to do large pieces of credit facilities that there used to be. If you spoke to people in capital markets in the ABL industry, they could probably give some very detailed data on how broad and how deep the market is in comparison with the ability to do some of the older, larger deals. That's affected by everything from industry consolidation to some lenders being just more selective.

MORSE: An interesting corollary of the consolidation within the industry for the larger institutions is that, with the larger commitments in specific credits from the major players, they are also looking for greater rights in the ongoing administration of the facility. So we are seeing an increased emphasis on having co-collateral agents in larger credits, which then, of course, raises issues concerning the relationship among the agents. But I think it's a reflection of the trend you're describing, Bill, where there are fewer players in the market leading to larger commitments.

BREWER: David, I agree with that observation and have definitely seen it: Detailed negotiations about what a co-collateral agent's rights would be and how those rights would be structured.

MORSE: If you go back historically and look at what has happened over the last couple of years, there is now a heightened sensitivity by lenders to being able to react faster and more aggressively, to being more proactive in the management and administration of credit facilities and everyone wanting to be sure that action is being taken as a company confronts financial distress.

COVE: Speaking of financial distress, there has been a significant increase in the number of companies filing Chapter



11 or even Chapter 7 this year. Many critics of the amendments to the bankruptcy code that was enacted back in 2005, say that the revised law made it more difficult for companies to successfully reorganize in Chapter 11. Do you all agree with that? If so, what changes would you recommend to the bankruptcy code to make it easier for companies to emerge from the bankruptcy process as viable businesses?

HELFAT: I think what we are witnessing in the present economy is that the special interest groups who were able to have such influence in amending the Bankruptcy Code in 2005, are now, ironically, not so sure that those amendments work to their benefit. Certainly in the real estate arena, if the Bankruptcy Code provided for more flexible rather than the "hard stop" dictated by the 2005 amendments, there would, in this economy, be a lot more landlords who would seriously consider giving extensions rather than taking their properties back. But I don't really think that the 2005 amendments will be



Left Column:
William Brewer
Richard Kohn

Right Column:
Jonathan Helfat
David Morse



repealed or modified any time soon. It took almost 10 years to pass the 2005 amendments and I don't think we are going to see a change in the commercial sections of the Bankruptcy Code in time to affect the current recession.

COVE: But, Jon, wouldn't you say the consensus is that those changes did make it harder?

HELFAT: I think what we are seeing, in part, is a direct result of the 2005 amendments to the Bankruptcy Code, as the amendments are restrictive both as to the court's discretion and the debtor's timeline in which to propose a plan. As a result, many of the cases being filed are "planned" bankruptcies with many of the reorganization issues being worked out in advance of a filing. That is a direct result of debtors not being able to abide by the deadlines imposed by the 2005 Amendments to the Code.

BREWER: The increase in planned bankruptcies for the bigger cases is also a reaction to, to some extent, a lack of new money or market liquidity which relates to the size and breadth and depth of the financing market. Whether it's the absence of traditional cash flow, multiple of earnings, lending for exit financing, or limits on the size and breadth and depth of ABL financing for exits, or all the constituencies necessary to accomplish a successful bankruptcy, what has resulted is companies getting stuck in bankruptcy, even big companies. This has led either to 363 sales, sometimes with lenders bidding in their debt, or to liquidations. These experiences have caused a desire, to the extent possible, to have planned bankruptcies.

HELFAT: I would say though that there is a real dichotomy here as the larger transactions are finding capital but the middle market and



smaller transactions are finding it very difficult to source capital.

BREWER: But a lot of that, and maybe that's the next question we should talk about, a lot of that capital is at some level either defensive by existing bank groups to protect their interests, or it's opportunistic in the sense of lenders willing either through a DIP or on exit to finance initially as a senior secured lender and thereafter to maybe be a different part of the capital structure if the company doesn't emerge from bankruptcy, or in the event of a subsequent restructuring or bankruptcy.

HELFAT: That's true, but if you go down a tier, you won't find that.

KOHN: But if you could wave a magic wand and change the Bankruptcy Code, I would think there are at least three provisions worth changing, and I'd be interested in hearing what the rest of you think. I would certainly vote for repealing Section 365(d)(4), which forces the retailers to make decisions with respect to leases within 210 days. That provision has not only hurt retailers; it has also made lenders less willing to support retail reorganizations because the retailers really don't have an adequate chance to make operating adjustments to their stores and to then assess which locations they should keep. And it's depressed going-concern sales for retailers through 363 sales, because potential buyers have insufficient time to assess the value of the operation. So that would be my first choice.

I would also want to repeal Section 503(b)(9), which grants an administrative priority to sellers of goods received by the buyers within 20 days of bankruptcy. This creates a huge cash burden in some bankruptcies, and can discourage reorganization because of the increased exit financing that's required.



And my third vote would be to modify Section 503(c), which makes it difficult for debtors-in-possession to give retention bonuses to key employees. There were certainly some abuses in the past when it came to retention bonuses, but I think 503(c) goes too far and makes it very difficult for companies in bankruptcy to keep the people they need at that critical time. What do you guys think?

BREWER: Richard, I would like to ask a follow-up question on your third point. To what extent is your third point about limits on retention bonuses a political hot button? And therefore, even though it's on your list, not realistic or viable from a legislative perspective?

KOHN: I totally agree. It would be very difficult to change that from a political standpoint.

HELFAT: While I think most of us would like to see modifications to the 2005 amendments, I think, in the practical sense, the Bankruptcy Code as it operates today has totally marginalized the reorganization process in favor of 363 sales, and why is that... because the reorganization process being more difficult under the Code-witness the 2005 amendments-combined with lack of capital in the financial market, the greatest return in the shortest time for most debtors is a sale of assets. This is true not just for GM and Chrysler but in all segments of the market.

MORSE: I think one of the other things that has happened is beyond a legislative fix. One of the reasons you see in some cases that an exit from bankruptcy pursuant to a plan of reorganization is so challenging is a result of the leverage that companies took on prior to the bankruptcy. The magnitude of the debt, whether first lien, second lien, mezzanine, secured cash flow,



unsecured cash flow, subordinated or otherwise, owing by companies leaves little room for additional financing to get the company through the Chapter 11 and out of it under a plan. The overleveraging of the companies, with multiple tranches of debt and extremely complicated capital structures that we have seen evolve over the last couple of years, has made the possibility of successful reorganization less likely. And, Jon, as you say, pushes the process in the direction of the 363 sale.

The other point I would note in the context of Chapter 11 financing is the development of the “roll-up” of pre-petition term loan debt that has only recently come on to the scene as a way for the existing pre-petition lenders to be induced to support the Chapter 11 and perhaps find a way to enhance their recovery, or at least reduce the loss. While it has always been used in the context of moving pre-petition revolving debt into the bankruptcy, the expansion of the concept to apply to pre-petition term debt is somewhat novel and seems to have been effective as a tool to facilitate companies’ ability to obtain Chapter 11 financing. All that being said, as I think Bill mentioned, Chapter 11 financing is really only being done in the defensive context, where existing capital that is already employed in the credit is looking to protect its recovery. We are only rarely seeing any new money coming in to provide Chapter 11 financing, particularly at the outset anyway.

BREWER: I would like to echo some of that, supplement it, and maybe even raise some new points in the following ways. The issue on what you called financing aspects of bankruptcies is really, whether it’s new money for DIPs or new money for exit financing, your point about given the leverage on companies and how little room there is, that these dynamics translate into the



difficulty which exists today in raising new money from new sources of capital, as opposed to defensive ABL loans. In addition, those defensive ABL DIP loans which lenders are willing to provide have led to additional protections beyond the borrowing base.

Roll-ups, funding limited to much more focused and disciplined budgets under the terms of the DIP financing documents and the financing order, milestones in DIP documents, are all among the sorts of things with respect to defensive DIP financing that have become more prevalent. The lack of new exit financing for companies, given today’s capital markets, the level of already existing leverage, and how long it takes to get a plan done versus the viability of getting a plan done within a reasonable period of time before emerging, has led to something that you’ve talked about with which I agree, limitations on the ability of certain companies to successfully reorganize. At least for the last little while, it has been difficult for debtors to do so, leading to the prevalence of 363 sales, Chrysler and GM being the largest public examples. In the retail context, liquidations are taking place faster. And I think that all those outcomes are an outgrowth of today’s financing markets.

COVE: Is it more difficult for companies to get DIP financing and or exit financing in this environment? If so, is that driving more companies towards liquidation?

KOHN: As some of the comments have already indicated, it is more difficult, driven in part by the skepticism concerning the reorganization process as a result of the 2005 amendments. Yet, even though we’ve seen mostly defensive DIP lending in the last year, we’ve actually seen a pick-up in non-defensive lending in our bankruptcy group as recently as the past few weeks.

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general, I think we'll see more situations in which lenders would be willing to provide new DIP financing.

The major strategy in so many chapter 11s has been the 363 sale, which is an incredibly important tool for secured lenders. One question I have is whether we'll see more of the kind of resistance to the use of 363 sales that we saw earlier this year in the Gulf Coast Oil case out of Texas, where the bankruptcy court refused to approve a 363 sale of the "crown jewel" assets of the debtor on the ground that the sale was a sub rosa plan of reorganization that circumvented the chapter 11 reorganization process.

HELFAT: At least in this part of the world, the 363 sale process is the most favored methodology for "reorganizations". While some courts may be slowing down the 363 sale process, at least in Delaware and New York, the courts are allowing 363 sales to go forward without interpretation. Arguments such as the need for the filing of a Chapter 11 Plan before a 363 sale can be conducted are not being given really any quarter.

Going to Bill's point, with the lack of capital in some segments of the market, we are seeing instances of equity or subordinated debt attempting to "prime" the existing pre-petition Chapter 11 lender in order to make available the additional funds necessary to bridge to a 363 sale as lenders are risk-averse in this economy. And again to Bill's point, we are seeing lenders taking larger "hold" positions, not being able to sell down, not being able to syndicate.

COVE: Are you seeing instances where companies that in the past would have been able to get DIP financing or exit financing and emerge from Chapter 11 as viable businesses are now forced to liquidate because of the scarcity of bankruptcy financing?



BREWER: I think your question is literally a hypothetical because what we have seen at least so far in 2009 is: partly it's Jon Helfat's answer about the use of 363, partly it's that DIPs tend to be defensive now, partly it's about whether sufficient financing exists, and partly it is an increase in liquidations. I think that this question is not one that is fully answerable at this stage in this market. Whether it's based on the changes to the Bankruptcy Code, whether it's based on the dynamics of the financial markets, whether it's the specific dynamics of the ABL market, your question really is not fully answerable from a real world perspective today. Instead, it should be answerable within a year or so when we have more experiences as data.

MORSE: What is happening, and the reason we keep talking about the 363 sale, is that to the extent that there is a business, it is resurfacing as the successor in the sale. The new paradigm that is most common seems to involve the formation of a "Newco" by either a new investor group or some combination of existing creditors and others, that purchase the assets out of the bankruptcy under Section 363 and it is the purchaser that continues the enterprise in a restructured, scaled-down form-rather than the "successor company" emerging from bankruptcy under a plan. In many respects the 363 sale has the same impact on the restructuring of the business as a plan might have, but it is just quicker and easier. And there is more likely to be financing for the purchaser as the vehicle that is being used for the restructuring rather than for a the financing of a plan of reorganization. There just seems to be more flexibility in using the 363 sale.

Although as alluded to, the sub rosa plan argument to derail 363 sales still seems to be consistently rejected by



the Bankruptcy Courts, I think we are starting to see some hesitancy on the part of the Bankruptcy Courts to necessarily let all 363 sales go through with the same speed as many have done to date. I guess Eddie Bauer is the poster child for this in terms of the willingness of the courts to just let the 363 sale go, without making certain that the process is generating the best possible return for the estate. We may start to see some heightened sensitivity on the part of courts in allowing 363 sales to occur as quickly-which has pluses and minuses because of the obvious impact on a business operating in Chapter 11 without a clear strategy for restructuring.

BREWER: David, I would agree with that. Although the 363 sale is a viable tool that has been used frequently recently, as Jon Helfat said earlier, especially in the Southern District of New York and in Delaware, there are not a lot of examples of it being rejected on the basis of the 363 sale being a sub rosa plan. However, going forward, I anticipate that courts will spend more time studying the 363, providing additional time for bidders, et cetera. The dynamic of how fast you can do a 363, what the 363 process will look like, how things may change from the Chrysler or GM examples, will be a very interesting development to watch in the near-to-medium term.

KOHN: I would agree with Bill's comment, but it wouldn't surprise me if we start to see more resistance to 363 sales, either of the type we saw in Gulf Coast Oil, or merely requiring more proof of the business necessity of a sale rather than a plan as required under Lionel, especially in other parts of the country.

HELFAT: I hear you guys, but the genie is out of the bottle and I believe 363 sales will continue to "rule the roost" for the next several years.

MORSE: As 363 continues to be used, there is a significant likelihood that more issues will emerge including, for example, some of the missteps in the context of the Polaroid bidding procedures, which were subject to close scrutiny by the court. There are going to be new issues surfacing as the use of 363 expands.

BREWER: If there is not enough financing in circumstances where companies are so over-levered going in to bankruptcy, then the real issue becomes sufficient financing to emerge from bankruptcy and, more immediately, sufficient financing to finance operations while in bankruptcy. Fundamentally, with respect to the questions of sub rosa plan and more time, and resistance to the speed of 363s, Judges, most of them, understand that in the absence of the ability of debtors to pay their bills and otherwise operate in Chapter 11, some bankruptcy cases simply do not allow the time for certain of these issues and avenues to be pursued, all of which must be balanced against all of the other aspects of the bankruptcy case. When present, these factors have led and will continue to lead to 363 sales rather than plans of reorganization.

HELFAT: I just don't think in today's economy that bankruptcy judges are going to allow employees to lose their jobs if the alternative is slowing down the 363 process. It just isn't going to happen in my view.

BREWER: I think that's right, Jon, that's what I meant by the absence of funding. If there is enough money and DIP financing so that the debtor stabilizes at some level while other important issues, including the plan of reorganization, are addressed, you are going to get one outcome. Where the circumstances

are much tighter from a liquidity perspective, for example, there are not many additional unencumbered assets or advance rates are already pretty high, that means that the bankruptcy process will require speedier solutions so that jobs and available business and outcomes for the benefit of all creditors are maximized to the extent possible.

COVE: For most of this decade, the economy was booming and the ABL markets were characterized by unprecedented liquidity, vigorous competition, and the entry of new players. During this time, many industry observers were saying that ABL was no longer considered as a financing option of last resort for borrowers, but was now becoming more of a mainstream option for lenders, regardless of their financial health.

Whether that is still true or not in this environment I'm not sure, but how would you all say the ABL industry has changed since you first started practicing? Also, has the role of attorneys in ABL changed over the years?

KOHN: I think the biggest change that I've seen in my career in asset-based lending has been the emergence of cross-border asset-based lending. When I started practicing, U.S. asset-based lenders wanted nothing to do with anything international. And that has changed dramatically as a function of the fact that the U.S. middle market has become globalized. It's been a sea change.

And the other change that I've seen is that in the last ten years, the value of asset-based lending as an important form of financing has increasingly become recognized in other countries. International organizations such as the United Nations and UNIDROIT have embraced asset-based lending, and have recognized the benefits that it

can have for businesses and, therefore, for economies. It's as if the world has discovered asset-based lending. You know, it's really amazing for me to sit in the United Nations and explain to delegates from 38 countries how a lock box works. Who would have thought that would happen? And with the recent completion of UNCITRAL's legislative guide on secured transactions, and its publication either later this year or early next year, I think we're going to see more and more countries changing their laws to make them favorable to asset-based lending in order to attract that kind of financing to their countries.

MORSE: Clearly, the expansion of asset-based lending in other jurisdictions, as Richard alludes to, is a significant trend. The other thing that I've seen, and I suspect Bill, Richard and Jon will echo this, is that there has been a convergence of asset-based lending with other capital market debt products. This "convergence" has created some interesting situations and dilemmas, and, frankly, I think problems, for asset-based lenders as you have more participants from the leverage finance/cash flow markets playing in the ABL market. Part of what we have seen over the last couple of years is a dilution of certain core principles of asset-based lending when the structuring of the ABL component of a multi-tranche credit facility is being driven by the providers of other debt products. And what we are seeing now in reaction to the change in the larger economy is a push to get back to some of those core principles.

In terms of considering ABL as the lender of last resort, I have always thought that description constituted a significant mischaracterization of the product. The beauty of asset-based lending is that it cuts across all levels of the credit quality spectrum and provides financing for companies that are per-



forming very well, as well as the classic turnaround financing. I do not believe that the flexibility of asset-based lending and its ability to adapt to larger credits, smaller credits, high quality performing credits and turnarounds has really been fully appreciated in the marketplace.

BREWER: I think I would answer this excellent question in a range of ways. First, asset-based financing has definitely changed a lot over time. My conclusion is that ABL today is a true capital markets product, not just for distressed companies, but for healthy companies, for a range of companies, large deals, medium-size deals, and smaller deals. Borrowers in many circumstances will select an ABL structure over a cash flow, non-borrowing based, non-ABL structure, even when those borrowers have access to other sorts of loan and financing structures because asset-based loans provide the ability to have fewer financial covenants or springing financial covenants that only spring if availability drops below a certain level, and if there are sufficient current assets for excess availability, plus a sufficient availability block, no financial covenants, all of this meaning that an ABL structure is the best for a borrower, as long as there is a sufficient borrowing base to structure a true asset-based loan.

We will continue to see the use of asset-based loans as an alternative to other capital markets products for a range of types of companies, types of industries, and for companies performing exceedingly well and companies facing challenges.

One example of the range of ABL uses: High yield bond transactions for larger companies, coupled with ABL revolvers, are a product that's been around for a while and are here to stay.

I was thinking about an advertising slogan that might describe today's ABL,



and I was thinking about this a little bit. If you will, "This is not your grandfather's asset-based lending product."

COVE: The last year and a half has been a very challenging period for the financial services industry. How do you foresee things playing out in ABL and the factoring markets for the rest of 2009 and into next year?

KOHN: I think we've already seen a pickup in asset-based lending deals in the last few months. I think that some banks and finance companies are sitting on a fair amount of money, and are working through integration issues with respect to recent acquisitions.

Also, while a year ago it was possible for lenders to buy into loans in the secondary market at large discounts, those discounts are not as large anymore. So, I think for those reasons, the time is right for lenders to start making new asset-based loans. Asset-based lending has typically thrived in a recessionary market, and I think the time is right for it to thrive now.

HELFAT: I think we are experiencing a very unusual economic cycle. We are seeing both deleveraging which is creating opportunities to invest and, as a result, we should see a flow of new deals but at the same time there will be more insolvencies because it is a delevered market and many borrowers can no longer service their debt.

MORSE: I share Richard and Jon's optimism about the level of new deal activity. I think Richard is right, that a lot of the liquidity issues have worked their way through the system and so we are going to see asset-based lenders really aggressively pursuing new financing opportunities.

There will not necessarily be the same quantity of transactions at the high end



of the market as to bond/ABL, cash flow/ABL, and the sponsor-driven acquisitions. These types of deals have a while yet to resurface. But I think in the mainstream of the middle market that has historically been the sweet spot of ABL, there is going to be a fair amount of activity.

BREWER: The first thing I'd say, and I suspect my co-panelists would agree with this: If we were good at predicting future economic outcomes, we would all do something else other than be lawyers for a living. So with that caveat, I would say that I agree that there is some thawing. I'm beginning to see it. I think that we will also see, as this thawing takes place, that it will take a little while. At the same time, I think we're also going to see more bankruptcy filings, concurrent with the thawing, because so many companies have so much leverage on them. There are still many challenges. Many sectors of our economy have had fewer sales, shrinking borrowing bases, and circumstances that result in the kind of liquidity problems that force workouts, restructurings and bankruptcy filings.

So, my conclusion is that, at least through the rest of 2010, it is still going to be challenging, choppy, if you will.

COVE: It is refreshing to hear the optimism, guarded or not. Hopefully, we will get to the end of the tunnel more quickly than we all could imagine. **TSL**