KIRKLAND & ELLIS LLP

KIRKLANDPEN
Private Equity Newsletter

February 19, 2010

Break-Up Fee Denied for Stalking-Horse Bidder in Bankruptcy Asset Sale

PENpoints

A federal appeals court recently upheld the denial of a break-up fee for a stalking-horse bidder whose bid was not conditioned on court approval of the break-up fee, illustrating the importance of carefully structured bids and purchase documentation.

Chapter 11 debtors often sell all or part of their assets pursuant to section 363 of the Bankruptcy Code. These bankruptcy sales typically involve an auction process that uses an initial or "stalking-horse" bidder to set the minimum price and other transaction terms against which other bidders bid. To compensate the stalking-horse bidder for the time and money invested in formulating the transaction, providing a "floor" price and establishing the potential terms for higher and better offers, the bidder is often awarded a court-approved break-up fee and expense reimbursement in the event it is outbid at auction.

Nonetheless, in a recent decision[1] a federal appeals court upheld the denial of a break-up fee for a stalking-horse bidder whose bid was not conditioned on court approval of the break-up fee, illustrating the importance of structuring a stalking-horse bid and related purchase documentation to require bankruptcy court approval of the break-up fee.

In 2007 Reliant Energy Channelview LP and Reliant Energy Services Channelview LLC (the "Debtors"), owners and operators of a cogeneration power plant in Channelview, Texas, filed Chapter 11 cases in the Delaware bankruptcy court. As part of their Chapter 11 cases, the Debtors decided to market and sell their Texas power plant. After an extensive marketing process, the Debtors entered into an agreement with Kelson Channelview LLC ("Kelson") to purchase the power plant.

The purchase agreement required the Debtors to seek immediate bankruptcy court approval of the sale. In the event that the court ordered the Debtors to conduct an auction, it also required the Debtors to *seek*—but crucially did not require them to *obtain*—court approval of a $15 million break-up fee and $2 million expense reimbursement provision. When the court ordered an auction, the Debtors, with the support of their creditors, requested court approval of the break-up fee and expense reimbursement. An interested purchaser who had submitted a prior offer for the power plant, Fortistar, LLC, objected to the break-up fee and expense reimbursement, asserting that the size of the break-up fee and expense reimbursement would deter it from submitting an otherwise higher and better bid.

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The bankruptcy court approved the $2 million expense reimbursement, but denied the break-up fee. The court found that the break-up fee was not necessary to preserve value where another bidder already had expressed an intention to bid at the auction. With its break-up fee denied, Kelson asserted that its bid was no longer binding and that it would not participate in the auction. At the auction, Fortistar submitted the winning bid and the bankruptcy court entered an order approving the sale of the power plant to Fortistar.

On appeal, the Third Circuit affirmed that a break-up fee should be approved only if necessary to preserve the value of a debtor's estate. Because Kelson's bid was only conditioned on the Debtors *seeking* (as opposed to actually *obtaining*) court approval of the break-up fee, the court determined that the break-up fee did not induce Kelson to make its bid and so was not necessary to preserve the value of the estate. The court also pointed to Fortistar's expressed intention to bid at the auction if the break-up fee was not approved as evidence that the fee was not necessary to preserve estate value, and, in fact, may have harmed the estate by discouraging other potential purchasers from bidding.

This decision highlights one court's close scrutiny of break-up fees and other bid protections. Break-up fees and expense reimbursement may be at risk where a bid

is not conditioned on court approval of these bid protections, particularly if other bidders are present. To best protect its ability to obtain a break-up fee, a stalking-horse bidder should carefully structure its bid and related purchase documentation in a manner that conditions the bid and continued participation in the sale process on court approval of all bid protections.

1 In re *Reliant Energy Channelview LP*, 2010 WL 143678 (3d Cir. Jan. 15, 2010).

If you have any questions about the matters addressed in this *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

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PENbriefs

"No Mas" to "Just Say No"?

With the expected increase in hostile takeover activity, Kirkland partners David Fox and Daniel Wolf recently published an *M&A Update* on the continued vitality of the "just say no" defense to unsolicited takeover advances. Messrs. Fox and Wolf discuss the history of the "just say no" defense, the Delaware courts' evolving view of the defense, how it has been used and to what effect, and certain factors that a court would likely take into account in evaluating its use by a target's board. They conclude that the vitality of the "just say no" defense is not and will not be the subject of a simple "yes or no" answer from the Delaware courts. Instead, the specific facts and circumstances of each case will likely determine the extent to which (and for how long) a court will countenance a target's board continuing refusal to negotiate with, or waive structural defenses for the benefit of, a hostile suitor. To learn more, please see our recent *M&A Update*.

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PENbriefs

FERC Proposes to Expand Exemption for Acquiring Public Utility Securities

The Federal Energy Regulatory Commission ("FERC") proposed a new rule that would facilitate investments in electric utilities and independent power producers. This rule, if it becomes final, should benefit private equity firms and others considering investments in this market because it would reduce regulatory risk and potential delays. Under FERC's proposed exemption, investors could hold up to and including 19.99% of the outstanding voting securities of a public utility or public utility holding company without obtaining prior FERC approval. To qualify for this exemption, the investor would need to make a filing with FERC that certifies that it does not influence control over the target public utility and will not to take certain actions that could otherwise demonstrate control (such as seeking board seats, directing day-to-day operations, or receiving non-public information). FERC is expected to issue a final rule after the March 29, 2010, deadline for public comment. To learn more, please see our recent *Alert*.

PENnotes

GoldenNetworking.com's
Distressed Investing Leaders Forum 2010
New York, New York
February 26, 2010

At GoldenNetworking.com's Distressed Investing Leaders Forum, which will be held in Kirkland's New York office, panelists will evaluate the current distressed investing landscape and discuss opportunities and pitfalls in distressed financial assets. Kirkland partner Kirk Radke will moderate a panel on "The Current Distressed Financial Landscape," partner Edwin del Hierro will participate in a panel titled "Opportunities and Pitfalls in Distressed Financial Assets," partner Jonathan Henes will moderate a panel on "Extraordinary Opportunities Investors Cannot Afford to Pass," and partner Thaddeus Tracy will moderate a panel on "Navigating the Landmines of Distressed Real Estate Investing."

The Practising Law Institute's
"Drafting Corporate Agreements 2010"
Chicago, Illinois
February 26, 2010

This PLI seminar will focus on drafting complete, concise and enforceable corporate agreements, and will discuss key terms of standard transactional agreements, when and how to use letters of intent, confidentiality and standstill agreements, and the wide range of M&A agreements, both public and private. Partner Gerald Nowak, a chair of this event, will give a speech on "Introduction and Universal Issues in Drafting Corporate Agreements."

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Private Equity Practice at Kirkland & Ellis

Kirkland & Ellis LLP's nearly 400 private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 200 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. In 2009, Kirkland received the awards for Best Law Firm (Private Equity Deals) and Best Law Firm (Fund Formation) in North America from *Private Equity International*. Mergermarket has ranked Kirkland first by volume for Global and North American Buyouts in its "Global M&A Round-Up for Year End 2008," and Pitchbook named Kirkland as one of the most active law firms representing private equity firms in its "Private Equity Breakdown" for 2009.

In 2009, for the second year in a row, *The Lawyer* magazine recently recognized Kirkland as one of the "The Transatlantic Elite," noting that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent." In addition, Kirkland's London office was named the 2008 "Banking Team of the Year" at the Dow Jones *Private Equity News* Awards for Excellence in Advisory Services.

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