Bankruptcy Court Decisions
WEEKLY NEWS & COMMENT

VOLUME 51, ISSUE 4 February 17, 2009

Perseverance and creativity deliver Wellman from the brink

Companies that gorged themselves with cheap and easy credit to support huge growth spurts outside their core strengths are heading for bankruptcy court.

What will the reorganization of these behemoths look like in 2009?

Wellman Inc. provides clues, says Jonathan S. Henes of Kirkland & Ellis LLP's New York restructuring practice, which represents Wellman in its reorganization efforts.

This year, companies that are able to emerge from bankruptcy will do so by significantly delivering their balance sheets, shutting down or selling their non-core assets, and reorganizing around their strongest operations, he said. The strong core business that remains will have a far easier time attracting an exit facility — a small one, perhaps, but the means to emerge nonetheless. "The business that emerges will be strong enough to operate in this terrible economic time, and someday, when the economy turns around, the company will be strong enough to grow again."

Those are a few of the lessons to be learned from *Wellman Inc.* Another lesson, however, is that if the goal is to reorganize such a company in this economy and in this credit environment, professionals and management alike are going to have to summon stony determination and untold creativity.

Chemical resins company Wellman filed Chapter 11 in the U.S. Bankruptcy Court, Southern District of New York on Feb. 22, 2008. Liquidation seemed imminent at nearly every stage of the 11-month process, yet after trimming all but its strongest business due to liquidity constraints imposed on it by its DIP lender (who ultimately agreed to *20 amendments* to the DIP), the debtor's Third Amended Plan of Reorganization was confirmed by Judge Stuart M. Bernstein on Jan. 14, 2009.

Go-go era capital structure prevents sale

Wellman manufactured three different products out of three separate facilities. Its strongest business, housed at a state-of-the-art facility, produced the resin used to make beverage bottles, while two challenged businesses, housed at more antiquated facilities, produced polyester fibers and nylon engineering resins.

Competition and rising supply costs landed the company in Chapter 11 just as the credit crisis was taking hold. Securing any DIP facility was a difficult task, let alone a DIP facility that would afford Wellman the time and flexibility to fix its operations and negotiate a plan of reorganization. Not surprisingly, the DIP agreement Wellman entered into with its prepetition lenders was expensive and restrictive. Any failure to meet the deadlines and milestones toward a sale process would constitute a default.

Despite that, Wellman set out on a dual path, simultaneously pursuing a sale and a reorganization, with a strong preference toward reorganization.

The path that would lead to a sale, it turned out, was a dead end. The debtor's capital structure, put in place during the "go-go times of the credit boom," made it nearly impossible to move forward with a sale, Henes said.

On its petition date, Wellman had $125 million outstanding on its $225 million revolving credit facility led by Deutsche Bank Trust Company Americas as agent. The credit facility was secured by liens on Wellman's accounts receivable, inventory and intellectual property. The debtor also had $185 million outstanding under a first lien term loan, secured by first priority liens on its property, plants and equipment. Additionally, a second lien term loan of $265 million was secured by a lien on virtually all of Wellman's assets.

With two groups of secured lenders holding liens on different assets, consent for a sale was not forthcoming, Henes said. "There just wasn't enough value to go around. Anytime we thought we had a deal with the second lien holders, there wasn't enough value for the first lien holders. If we could have reached a deal with the first lien holders, then it wouldn't leave enough value for the second lien holders. It was a conundrum."

The debtor informed the DIP lender its lien holders would not consent to the sale, but the lender declined to amend the DIP to allow the debtor time to explore alternatives. Already, Wellman wasn't on a path to a sale, or on a path to reorganization; it was on the fast track to liquidation.

Wellman's management team and advisors went to work explaining to its stakeholders that the company was clearly more valuable operating than closed down. "We spent an incredible amount of time communicating with all of our stakeholders and educating them on the value of the business," said Henes. "And the communication paid off. We were able to stave off liquidation and we lived to fight another day."

As a result of Wellman's hard work, one of Wellman's second lien holders agreed to take out $20 million of the DIP loan. Based on this, the DIP lender agreed to amend the facility to extend the deadlines and replace the sale milestones with plan milestones. With the opportunity to negotiate a plan of reorganization, liquidation was averted, if only fleetingly.

Wellman worked tirelessly to bring its stakeholders together on a consensual plan of reorganization. However, a consensual plan was not forthcoming. To meet the deadlines in the DIP, Wellman proposed a confirmable plan. Wellman's plan, supported by the second lien lenders and the creditors' committee, proposed to retain the use of the first lien lenders' collateral following emergence, in exchange for a new note with a value equal to the collateral. Just what the value of that collateral was, however, was a point of contention. Ultimately, the court sided with the first lien holders, and the determined value of the collateral rendered the plan infeasible. Once again, liquidation seemed likely.

A focus on core business renews hope

Professionals and management alike could have given up then, but *Wellman* just wasn't proving to be that kind of case. And before long, Lazard, Wellman's financial advisors, had an idea. Lazard proposed that the company exit the fibers and engineering resins businesses and wind down its operations at its two older facilities, the proceeds of which would be used to pay down the DIP. The company could then reorganize around its strongest business. It was a painful decision, said CEO Mark Ruday. "Making a decision that involves cutting jobs is never easy, but we had to focus on the future. The choice was between saving 200 jobs by losing 700, or just losing 900 jobs," he said.

And indeed, things were looking up. It was an idea that convinced the DIP lender to amend the facility once again. It also won the support of the second lien holders, two of whom — Sola Ltd. and BlackRock Financial Management Inc. — expressed a willingness to invest new money in the deal. The first lien holder, on the other hand, remained skeptical.

Battle weary and liquidity strapped, Wellman wasn't up for another battle with its first lien holders, so counsel tried an entirely different tact. Wellman would file what they called a binary plan. They amended the plan to reflect the new value investment, and to reflect a 70-30 equity split, 70 percent to the first lien holders, and 30 percent to the second lien holders. The choice offered to the first lien holders was clear. Vote yes and the plan gets confirmed with Wellman emerging as a going concern, vote no and the plan fails, with Wellman liquidating and shutting its doors forever.

It didn't sway the first lien holders, however. Preliminary votes showed that despite overwhelming support from its second lien holders and its unsecured claimants, Wellman didn't have the requisite votes from the first lien holders to confirm the plan.

The 3-day deal

The conversation turned to liquidation and WARN Act notices; it was game over for Wellman.

But the next day, a Saturday, Henes awoke determined. "We had been teetering on the edge of liquidation throughout the entire process, but every single time we had found a way out of it. I thought there had to be a way around it," he said.

Lazard's Brandon Aebersold, Wellman's financial advisor, woke up in the same frame of mind. Wellman had but three days left before it defaulted on its DIP. A deal couldn't be reached over the course of 11 months, but somehow, reaching a deal over the next three days seemed plausible, as it turns out, with good reason.

Over the course of those three days of discussions with its stakeholders, it came to light that the first lien holders voted against the plan in large part because it was engaging in discussions with a potential buyer interested in purchasing the state-of-the-art plant once it was shut down in the liquidation.

What the debtors knew, and the first lien holder apparently didn't know, however, was that Wellman's largest supplier was, for its own reasons, strongly in favor of the debtors' plan. After a meeting was called, in which the supplier explained their support for Wellman's plan, the case finally changed course.

The first lien holders, however, wanted a modification to the plan in exchange for yes votes. They wanted convertible notes instead of straight equity in the company. Around the clock negotiations ensued. And on Dec. 18, 2008, Wellman and its major stakeholders agreed on the terms of the amended plan, which received the overwhelming support of all voting classes.

Wellman emerged as a private company on Jan. 31, 2009, with Sola and BlackRock investing $35 million in exchange for 50 percent of the voting power of reorganized Wellman. The remaining 50 percent voting power was provided to the old first and second lien holders in consideration for extinguishing their prepetition debt. The company entered into a $35 million revolving credit facility with CIT, secured by a first lien on substantially all of Wellman's assets.

"There were many times when we could have said, 'We gave it our all, let's just let this one go,'" Henes said. "If it weren't for some incredible creativity and the determination to keep fighting even after we were all beaten and bloodied, Wellman never would have emerged."

He expects to see more executives who, in an effort to emerge with as strong a company as possible, decide to either shutter weak businesses or sell them, even if it means selling them for far less than they would have fetched just a few years ago.

The ad hoc committee of first lien holders was represented by Haynes and Boone; Chilmark Partners served as financial advisor. The second lien holders were represented by Akin Gump Strauss Hauer & Feld LLP; Houlihan Lokey served as financial advisor. Winston Strawn LLP served as counsel to the DIP lender; Alvarez and Marsal served as financial advisor. Ropes & Gray served as counsel for the creditors committee. ■