3. PROVISIONS RELATING TO CONSIDERATION

3.1 Purchase-price adjustments

As previously discussed, consideration paid under the 60 sale transactions analyzed ranged from approximately $200,000 on the low end to approximately $4 billion on the high end. From the selling debtor's perspective, it is preferable to have the purchase price paid in cash at closing.[359] Payment over time is disfavored, especially if the debtor is liquidating, because its creditors wish to receive distributions as soon as possible, and any delays usually result in increased administrative costs to the estate and, thus, lower distributions to creditors. In addition, for similar reasons, debtors typically prefer to have a known, set purchase price for the assets being sold rather than having the purchase price be subject to downward adjustments prior to or following the closing.

In sale transactions in which there will be a delay between signing the purchase agreement and consummating the sale itself, however (for example, in order for the parties to obtain an order approving the transaction from the bankruptcy court), a buyer may negotiate a mechanism for adjusting the purchase price to avoid large fluctuations in the value of assets while the seller continues to conduct its business pending the closing of the sale transaction. Such adjustments may be necessary from a buyer's perspective to ensure that it maintains the benefit of its bargain. In addition, when the assets being sold include, among other things, inventory, accounts receivable, cancelable customer contracts and other items whose precise values may be impossible to determine prior to the closing of a sale transaction, the purchase price may be adjusted by the parties either at or after the closing when a more accurate determination can be made. A purchase-price adjustment also may be used to cover other matters that cannot be determined by the parties as of the closing date, such as payment for the assignment of contracts where the contracting party has objected to

359 Although cash consideration is almost always favored by a debtor, total overall consideration paid by the buyer, including the value attributable to liabilities of the seller assumed by the buyer under the purchase agreement (such as the assumption of payroll obligations, accrued but unused employee vacation pay, and cure costs associated with executory contracts and unexpired leases assigned to the buyer), should always be taken into account.

assignment or disputed the appropriate cure cost, or title problems, lien issues, tax claims and/or potential environmental claims.

In these situations, parties often will estimate the purchase price prior to closing, establish procedures to later adjust the purchase price (as appropriate) and establish escrow accounts from which such purchase-price adjustments may be paid.

Appendix 3.1 is a summary of language used relating to purchase-price adjustments contained in the sale transactions analyzed, including whether the parties capped the amount of such adjustments and whether the parties negotiated a holdback of the purchase price and/or an escrow arrangement to secure payment for such adjustments.[360] Of the 60 sale transactions analyzed, approximately two-thirds (or 38 in total) contained some form of purchase-price adjustment.[361] Based on our analysis, whether the parties adopted price-adjustment mechanisms appears to be deal-specific, and did not correlate with any particular jurisdiction, industry or transaction size. For example, several sale transactions in the telecommunications industry provided for purchase-price adjustments, while several other sale transactions in the same industry did not.[362] Even different sale transactions in the same bankruptcy case were not consistent with respect to their adoption of purchase-price adjustment mechanisms.[363]

Generally, purchase-price adjustments were measured against a minimum or maximum threshold amount, *i.e.*, a buyer may be able to adjust the purchase price downward for changes in inventory levels from the signing of the purchase agreement to closing, but only if the value of the inventory as of the closing date was below a certain specified

360 This Section does not include an analysis of price adjustments based solely on post-closing breaches of representations and warranties and any post-closing indemnification obligations of the parties relating thereto. Rather, for an analysis of representations and warranties in sale transactions we reviewed, including buyer remedies based on post-closing breaches of such representations and warranties by the seller, *see infra* Section 6.1.2.

361 *See* App. 3.1 (*ABC-NACO*; *Acme Metals*; *Am. Int'l Refinery*; *ANC Rental (Midwest sale)*; *Asia Global Crossing*; *Bethlehem Steel*; *Brac Group*; *Burlington Indus.*; *Centis (consumer sale)*; *Chevys*; *Cone Mills*; *Daisytek*; *e.spire Communications (Xspedius sale)*; *Enron (Bridgeline sale)*; *Enron (wind turbine business sale)*; *Gayley & Lord*; *Ha-Lo*; *Iridium*; *Kaiser Aluminum (Tacoma sale)*; *Kellstrom*; *K-Mart*; *M. Fabrikant & Sons; New Century; Northpoint Communications*; *Onsite Access*; *Orbcomm Global*; *Owens Corning*; *Peregrine*; *Pillowtex*; *RSL Com Primecall*; *Russian Tea Room*; *Safety-Kleen*; *Teligent*; *TWA*; *U.S. Aggregates*; *U.S.Gen New England*; *Velocita; Weld Wheel*).

362 *See* App. 3.1 (*Compare Asia Global Crossing*; *e.spire Communications (Xspedius sale)*; *Northpoint Communications*; *Onsite Access*; *RSL Com Primecall*; *Teligent*; *Velocita* (all providing for some form of purchase-price adjustments) *with Clarent*; *Integrated Telecom Express*; *Int'l Fibercom*; *Metromedia Fiber*; *Network Plus* (not providing for any purchase-price adjustments)).

363 *See generally Centis (consumer sale)* (providing for purchase-price adjustment) and *Centis (G. Neil sale)* (no purchase-price adjustment contemplated).

dollar amount.[364] At least one sale transaction, in the Cone Mills case, permitted the parties to terminate the agreement if the selling company's EBITDA reached certain minimum or maximum amounts. Similarly, at least one other sale transaction, in the *Trans World Airlines* case, prohibited any purchase-price adjustments until the aggregate of such adjustments exceeded $5 million, at which point the parties would be permitted to make the full amount of all adjustments to the purchase price as contemplated in the purchase agreement.

The vast majority of the 38 sale transactions that contained some form of purchase-price adjustment permitted pre-closing and/or post-closing purchase-price adjustments that corrected pre-closing estimates of certain obligations and liabilities allocated to the buyer. Although the scope and form of these types of purchase-price adjustments varied significantly, the following are some of the more common types of purchase-price adjustments made based on the sale transactions analyzed:

- **Assets**. Adjustments based on damaged assets conveyed at closing or assets that were purchased but never conveyed to the buyer;[365]
- **Assumed Liabilities**. Where estimated liabilities assumed by the buyer at closing exceeded a specified dollar amount (including accrued employee obligations);[366]
- **Accounts Receivable, Inventory or Cash**. Where actual accounts receivable, inventory and/or cash on hand were greater than or less than estimated closing amounts;[367]
- **Working Capital or EBITDA**. Adjustments based on the seller's failure to meet working capital or EBITDA targets;[368]
- **Customers**. Where actual customer liabilities and/or customer volume were greater than or less than estimated amounts;[369]

364 *See, e.g.*, App. 3.1 (*ABC-NACO*; *Asia Global Crossing*; *Bethlehem Steel*; *Centis (consumer sale)*; *Chevys*; *Cone Mills*; *Owens Corning*; *Peregrine*; *RSL Com Primecall*).

365 *See, e.g.*, App. 3.1 (*ABC-NACO*; *Enron (wind turbine business sale)*; *Kellstrom*; *New Century; Northpoint Communications*; *Peregrine*; *RSL Com Primecall*; *TWA*; *U.S.Gen New England; Weld Wheel*).

366 *See, e.g.*, App. 3.1 (*Brac Group*; *Centis (consumer sale)*; *Ha-Lo*; *RSL Com Primecall*; *TWA*).

367 *See, e.g.*, App. 3.1 (*ABC-NACO*; *Asia Global Crossing*; *Burlington Indus.*; *Centis (consumer sale)*; *Daisytek*; *Ha-Lo*; *Kellstrom*; *Teligent*; *TWA*; *U.S. Aggregates*; *U.S.Gen New England*).

368 *See, e.g.*, App. 3.1 (*Bethlehem Steel*; *Cone Mills*; *Ha-Lo*; *Owens Corning*; *Safety-Kleen*; *U.S. Aggregates*).

369 *See, e.g.*, App. 3.1 (*Centis (consumer sale)*; *K-Mart*; *Onsite Access*).

- **Prepaid Expenses and Services**. Upward adjustments to the purchase price to reimburse the seller for prepaid expenses and/or services;[370]

- **DIP Financing**. Adjustments to the purchase price based on the repayment of outstanding obligations under a debtor-in-possession financing arrangement or assumption by the buyer of other secured loan obligations of the seller;[371]

- **Administrative Expense and Priority Claims**. Upward adjustments to the purchase price to allow the seller to satisfy certain administrative expense and/or priority claims;[372] and

- **Cure Amounts**. Where cure amounts for executory contracts assumed and assigned to the buyer exceeded estimates and/or the buyer added or deleted certain executory contracts from the proposed assignment lists, thus altering the seller's cure obligations and/or rejection damage claims.[373]

Other notable, but less common, purchase-price adjustment provisions included reductions in the purchase price for failing to close the sale transaction or confirm a plan of reorganization by a certain date[374] and adjustments based on certain environmental and/or foreign tax claims that could not be ascertained until after the closing date.[375] Only two of the sale transactions addressed the ability of the parties to offset existing claims against the purchase price, and in both instances, such offsetting was prohibited.[376]

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370 *See*, *e.g.*, App. 3.1 (*Bethlehem Steel*; *e.spire Communications (Xspedius sale)*; *Iridium*; *Orbcomm Global*; *TWA*).

371 *See*, *e.g.*, App. 3.1 (*Bethlehem Steel*; *TWA*).

372 *See*, *e.g.*, App. 3.1 (*Bethlehem Steel*; *Chevys*; *Chevys*; *Cone Mills*; *TWA*). These type of purchase-price adjustments help to ensure that the debtor-seller will be able to confirm a plan of reorganization by having sufficient funds available to satisfy in full its administrative expense and priority claim obligations.

373 *See*, *e.g.*, App. 3.1 (*Bethlehem Steel*; *e.spire Communications (Xspedius sale)*; *Ha-Lo*; *K-Mart*; *Northpoint Communications*; *TWA*; *Velocita; Weld Wheel*).

374 *See* App. 3.1 (*Bethlehem Steel*; *K-Mart*).

375 *See* App. 3.1 (*Acme Metals*; *Am. Int'l Refinery*; *Centis (consumer sale)*; *Enron (wind turbine business sale)*; *Gayley & Lord*; *Kaiser Aluminum (Tacoma sale)*).

376 *See* App. 3.1 (*Brac Group*; *Enron (Bridgeline sale)*). Even where a purchase agreement is silent with respect to a buyer's ability to offset claims against the purchase price, the right to offset a pre-petition unsecured claim against the price of property purchased post-petition is questionable at best. In such a situation, there arguably is no mutuality of obligation (*i.e.*, the post-petition debtor is not the same as the pre-petition corporate entity), and thus no basis to assert an offset. In addition, permitting offsetting of post-petition claims also may be inequitable, especially where other administrative expense claims of the debtor may not be paid in full in the bankruptcy case.

When negotiating a sale transaction, a buyer would be well advised to determine what variables exist in the purchase price and negotiate the ability to adjust the purchase price, post-closing, to account for those variables. In this way, a buyer can protect itself from a change in the position of the company or assets it is purchasing, unexpected and unbargained for liabilities and/or misdeeds by the other party to the transaction.

On the other hand, a buyer should be aware that purchase-price adjustments often provide for the possibility of an upside to the seller as well. For example, several of the sale transactions analyzed contemplated that although the purchase price could be adjusted downward to the benefit of the buyer, the seller also could benefit from a purchase price increase if certain targets were satisfied.[377] In addition, an offer to purchase assets from a debtor-seller that does not contain a purchase-price adjustment may be a significant factor in favor of a particular buyer's offer over others that require purchase-price adjustments. Moreover, the ability of a buyer to require purchase-price adjustments may vary with the level of competition for the assets. For example, the stalking-horse purchaser in the *Cable & Wireless* sale transaction initially had negotiated purchase-price adjustments that were estimated to decrease the purchase price from $155 million to approximately $50 million. Based on the results of a competitive auction process with 7 active bidders, these purchase-price adjustment provisions subsequently were removed and the assets were sold for approximately $155 million in cash consideration.

3.1.1 Caps on Price Adjustments

Because the debtor and its creditors want some certainty regarding the amount that will be paid and will be available for distribution in the bankruptcy case, the maximum amount of any downward purchase-price adjustment is sometimes capped. In addition, there may be separate caps for individual items making up the adjustment. Appendix 3.1 provides a summary of the language used in the sale transactions analyzed relating to caps placed on the amount of purchase-price adjustments.

Based on our analysis, caps on purchase-price adjustments were not prevalent. Of the 38 sale transactions that even contained a purchase-price adjustment mechanism, only eight transactions provided maximum caps by which the parties could adjust the

377 *See, e.g.*, App. 3.1 (*ABC-NACO*; *Asia Global Crossing*; *Enron (wind turbine business sale)*; *RSL Com Primecall*; *Safety-Kleen*; *Teligent*; *TWA*; *U.S. Aggregates*).

purchase price, in amounts ranging from a limited cap of $200,000 to $12 million.[378] Where such a cap was set, it was generally between 1 percent and 25 percent of the initial purchase price, with the median cap being approximately 8.8 percent. In addition, although one of the sale transactions did not have a maximum cap on price adjustments, it did provide for a minimum cap requirement of $500,000; *i.e.*, the parties were not permitted to make any price adjustments for the first $500,000 on account of certain liabilities, but adjustments were permitted for any amounts in excess of $500,000.[379]

Although most of the remaining 30 sale transactions were silent with respect to any limitations on the amount of the price adjustments (thereby implying that no such limit existed), at least one sale transaction specifically stated that the retention of monies in escrow following the closing, which were to be applied to satisfy any post-closing purchase-price adjustments, was not intended to impose any limit on the amount that could be recovered on account of such adjustments.[380]

3.1.2 Holdbacks from the Purchase Price

Once the entire purchase price has been paid to the debtor, the buyer may have a much more difficult time enforcing any post-closing purchase-price adjustments. Thus, to the extent that a 363 sale contemplates any post-closing price adjustments or other seller indemnification provisions,[381] a buyer should take precautions to ensure that the debtor-seller, especially a debtor-seller that is liquidating its estate or is unable to pay its post-petition administrative expenses in full, will have funds sufficient to meet its post-closing obligations. For example, a seller's deferral of a portion of the purchase price can provide a means to enforce the buyer's rights under the purchase

378 *See* App. 3.1 (*ABC-NACO* ($10 million cap, or 13.3 percent of the final purchase price); *Am. Int'l Refinery* ($500,000 cap, or 18 percent of the final purchase price); *Centis (consumer sale)* (no cap on price adjustments except for $200,000 cap relating to foreign tax claim, which cap is less than 1 percent of the final purchase price); *Enron (wind turbine business sale)* ($3.8 million cap, or 1 percent of the final purchase price); *Kaiser Aluminum (Tacoma sale)* ($4,037,167 million cap, or 25 percent of the final purchase price); *New Century* ($5 million cap, or 2.7 percent of the final purchase price); *Pillowtex* ($9 million cap, or 7 percent of the final purchase price); *U.S.Gen New England* ($12 million cap, or 2.4 percent of the final purchase price)).

379 *See* App. 3.1 (*Peregrine*). Although also establishing a maximum cap, the parties in the *New Century* sale transaction negotiated a minimum 1 percent basket whereby the parties could not assert a claim against one another unless and until the aggregate value of their respective indemnity claims exceeded 1 percent of the cash purchase price, after which point the indemnifying party would be liable for all such losses.

380 *See* App. 3.1 (*Brac Group*).

381 The holdback of a portion of the purchase price also may secure any claims by the buyer for breach of a representation or warranty by the seller to the extent such obligations survive the closing. For a more detailed discussion of representations and warranties that survive closing and remedies for post-closing breaches of the same, see infra Section 6.1.3.

agreement and ensure that there will funds available to compensate the buyer for any seller liabilities arising upon final determination of the purchase-price adjustments.

From a buyer's perspective, it is typically more favorable to require that any holdback or other monies securing the payment of a post-closing purchase-price adjustment be held by an independent third party, such as an escrow agent, rather than by the debtor-seller. Although this may increase the parties' transaction costs, which may not be practical or desirable with smaller transactions, using a third-party agent reduces the risk that the debtor will distribute all of its money and other assets to its creditors before final reconciliation of the purchase-price adjustments, and allows the buyer to retain more control (or at least control equal to that of the debtor-seller) over the disposition of such funds.

Of the 38 sale transactions that provided for purchase-price adjustments, less than one-half (only 15) required a holdback of the purchase price or the creation of a reserve or other protection to ensure that the debtor-seller would have sufficient funds to meet its post-closing obligations to the purchaser.[382] The amounts reserved in escrow or otherwise subject to some form of protection to ensure payment ranged from \$395,000 to \$10 million, and ranged from 1 percent to 100 percent of the final purchase price. On average (excluding the two sale transactions that reserved 100 percent of the purchase price and the one unknown percentage), the amounts reserved in escrow or otherwise subject to some form of protection to ensure payment represented approximately 8.5 percent of the final purchase price.

Most of these sale transactions—13 out of the 15—secured such payment obligations through the creation of an escrow account upon closing.[383] In the sale transactions we analyzed, parties often determined the amount of the escrow account by ascertaining

382 *See* App. 3.1 (*ABC-NACO* (\$10 million in escrow, or 13.3 percent of the final purchase price); *Am. Int'l Refinery* (\$500,000 in escrow, or 18 percent of final purchase price); *ANC Rental (Midwest sale)* (\$2.9 million in escrow, or 100 percent of the final purchase price); *Brac Group* (\$500,000 in escrow, or 2.5 percent of the final purchase price); *Centis (consumer sale)* (\$900,000 in escrow, or 3 percent of the final purchase price); *Daisytek* (amount unknown, but 10 percent of estimated purchase price at closing); *e.spire Communications (Xspedius sale)* (unknown); *Enron (wind turbine business sale)* (\$3.8 million entitled to administrative expense priority, or 1 percent of the final purchase price); *Kaiser Aluminum (Tacoma sale)* (\$4,037,167 in escrow, or 25 percent of the final purchase price); *New Century* (\$5 million in escrow, or 2.7 percent of the final purchase price); *Peregrine* (\$10 million in escrow, or 2.9 percent of the final purchase price); *RSL Com Primecall* (debtor agreed to retain \$2.6 million in estate, or 18 percent of the final purchase price); *Safety-Kleen* (\$5 million in escrow, or 1.6 percent of the final purchase price); *Teligent* (\$395,000 in escrow, or 100 percent of the final purchase price); *U.S. Aggregates* (\$4.5 million in escrow and \$500,000 in a deferred payment holdback from another sale transaction, or 3.6 percent of the final purchase price)).

383 *See* App. 3.1 (*ABC-NACO*; *Am. Int'l Refinery*; *ANC Rental (Midwest sale)*; *Brac Group*; *Centis (consumer sale)*; *Daisytek* (requiring seller's counsel, acting in capacity as an escrow agent, to hold funds); *e.spire Communications (Xspedius sale)*; *Kaiser Aluminum (Tacoma sale)*; *New Century*; *Peregrine*; *Safety-Kleen*; *Teligent*; *U.S. Aggregates*).

one party's maximum obligation for a particular liability.[384] For example, to address any unresolved objections to proposed cure payments that remained pending at closing, the parties in *e.spire Communications (Xspedius sale)* agreed that the seller would place in escrow an amount equal to the difference between the amount claimed in any cure objection and the cure amount it initially scheduled for an objecting party. In *Centis*, the parties provided for an aggregate purchase price holdback of $900,000, which amount was allocated to satisfy different post-closing obligations. By reserving specific amounts for potential or undetermined liabilities, parties are able to ensure that (1) there will be sufficient funds to pay these potential liabilities and (2) each party will receive the full benefit of its bargain.

As a general rule, when the amount of any purchase-price adjustment has been determined, the escrowed amount generally will be released. Depending on the adjustment, it may be released to the seller, the buyer, or in part to each. Payment could be triggered by the completion of a post-closing purchase price reconciliation, such as a physical inventory of the purchased assets, validation or collection of the purchased receivables, or entry of final orders approving assignment of contracts or leases. Alternatively, payment could be triggered by the passing of a certain, specified period without the occurrence of a negative event, such as a claim for breach of a representation or warranty or the cancellation of certain customer contracts.

Among the two remaining sale transactions that did not provide for the retention of funds in an escrow account, the parties in the *Enron (wind turbine business sale)* sale transaction agreed to treat any claims for purchase-price adjustments as an administrative expense entitled to priority under Bankruptcy Code §§503(b)(1) and 507(a)(1), and the parties in the *RSL Com Primecall* sale transaction agreed that the debtor would retain at least $2.6 million in the estate until expiration of the survival period. Although the parties in *ANC Rental Corp. (Midwest sale)* initially provided for the establishment of an escrow account, the parties also agreed that the seller could, with the buyer's consent and in lieu of the escrow account, provide the purchaser with an allowed administrative claim secured by all assets of the seller and *pari passu* with the liens and distribution rights of the seller's other secured creditors.

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384 The *ANC Rental (Midwest sale)* and *Teligent* escrow accounts were the exception to this rule, both of which required that the entire purchase price amount be placed in escrow. *See id.* (*ANC Rental (Midwest sale)*; *Teligent*).

3.1.3 Procedures for Reconciling Purchase-price Adjustments

Where parties determine that pre-closing or post-closing price adjustments are necessary, they often will set forth detailed procedures within the purchase agreement for determining the amount and timing of such price adjustments. Such procedures are necessary to ensure timely reconciliation of price adjustments and the release of funds to the appropriate parties. Such procedures also can narrow the scope of potential areas of dispute among the parties and facilitate a quick and amicable resolution of any price-adjustment issues without the need for protracted and costly litigation.

Appendix 3.1.3 is a summary of the language used in the sale transactions we analyzed relating to procedures adopted by the parties for determining purchase-price adjustments. Of the 38 sale transactions that contained purchase-price adjustment provisions, 29 contained detailed procedures for determining such adjustments.[385] The procedures in most of these 29 sale transactions generally followed a similar pattern:[386]

- One party must prepare a statement setting forth a detailed calculation of the purchase-price component or components at issue (*i.e.*, cash on hand at closing, inventory on hand at closing, environmental liabilities, etc.);
- The other party has a period of time during which it may investigate and, if appropriate, formally dispute the calculation;
- The parties are allotted a period of time during which they must work together to attempt to resolve any disputed calculations; and
- If informal dispute-resolution attempts fail, the parties will refer the matter to an independent accountant, mediator, arbitrator or the bankruptcy court.

385 *See* App. 3.1.3 (*ABC-NACO*; *Acme Metals*; *Am. Int'l Refinery*; *Asia Global Crossing*; *Bethlehem Steel*; *Brac Group*; *Burlington Indus.*; *Centis (consumer sale)*; *Cone Mills*; *Daisytek*; *Enron (wind turbine business sale)*; *Gayley & Lord*; *Ha-Lo*; *Kaiser Aluminum (Tacoma sale)*; *Kellstrom*; *K-Mart*; *M. Fabrikant & Sons; New Century; Northpoint Communications*; *Onsite Access*; *Owens Corning*; *Peregrine*; *RSL Com Primecall*; *Safety-Kleen*; *Teligent*; *TWA*; *U.S. Aggregates*; *U.S.Gen New England; Weld Wheel*).

386 Although there were purchase agreements that contained significantly less-complicated procedures, those agreements generally dealt with a limited price-adjustment calculation (for example, reconciliations for environmental clean-up claims or cure claims) where extensive procedures were unnecessary. *See, e.g.*, App. 3.1.3 (*Acme Metals*; *Am. Int'l Refinery*; *Kaiser Aluminum (Tacoma sale)*).

Within these general parameters, however, many procedural differences existed. Specifically, the agreements differed with respect to when the procedures were operative (*i.e.*, pre-closing, post-closing or both), the timing of the procedures, which party was responsible for preparing the closing statements, the accounting methods used in calculating the closing statements, the standard of cooperation required of the parties in resolving disputes, limitations on a party's ability to dispute the closing statements, whether the responsible party was required to remit nondisputed funds pending resolution of disputed matters, who would resolve disputes where the parties were unable to do so themselves, how such persons would be selected and who would bear their cost.

Six of the 38 purchase agreements with price-adjustment provisions contained price-adjustment procedures relating solely to the pre-closing period,[387] 14 contained price-adjustment procedures relating solely to the post-closing period,[388] and nine contained price-adjustment procedures relating to both pre-closing and post-closing periods.[389] In the sale transactions we analyzed, pre-closing procedures were less prevalent than post-closing procedures. This result is not surprising because, for purposes of closing, parties generally will conform to the seller's price estimates (who is most familiar with the business), subject to post-closing verification. Nevertheless, 15 of the asset-purchase agreements we analyzed contained some degree of pre-closing procedures.[390] Generally, these procedures simply required one or both parties to submit price calculations relating to certain liabilities (such as inventory levels, balance sheets, environmental liabilities, etc.) before closing. In all but two agreements, the seller was responsible for preparing the pre-closing statements.[391]

In most of the pre-closing procedures we reviewed, the submitted calculations were deemed "final" for purposes of closing—subject to post-closing adjustments.

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387 *See* App. 3.1.3 (*Acme Metals*; *Cone Mills*; *Gayley & Lord*; *Kaiser Aluminum (Tacoma sale)*; *Teligent*; *U.S.Gen New England*).

388 *See* App. 3.1.3 (*ABC-NACO*; *Am. Int'l Refinery*; *Asia Global Crossing*; *Bethlehem Steel*; *Brac Group*; *Daisytek*; *M. Fabrikant & Sons; Northpoint Communications*; *Onsite Access*; *Peregrine*; *RSL Com Primecall*; *Safety-Kleen*; *U.S. Aggregates; Weld Wheel*).

389 *See* App. 3.1.3 (*Burlington Indus.*; *Centis (consumer sale)*; *Enron (wind turbine business sale)*; *Ha-Lo*; *Kellstrom*; *K-Mart*; *New Century; Owens Corning; TWA*).

390 *See* App. 3.1.3 (*Acme Metals*; *Burlington Indus.*; *Centis (consumer sale)*; *Cone Mills*; *Enron (wind turbine business sale)*; *Gayley & Lord*; *Ha-Lo*; *Kaiser Aluminum (Tacoma sale)*; *Kellstrom*; *K-Mart*; *New Century; Owens Corning*; *Teligent*; *TWA*; *U.S.Gen New England*).

391 In *Teligent*, the buyer and seller were jointly responsible for conducting a pre-closing physical inventory. In *New Century*, the buyer was responsible for retaining an audit firm to calculate adjustments and the buyer had the right to reduce the purchase price if the buyer determined, in its sole discretion, that certain assets were not going to be conveyed to it at closing.

Accordingly, parties that did not prepare the calculations were not allowed to respond to pre-closing reports. A response period was often unnecessary because post-closing procedures gave both parties the opportunity to correct errors and, if necessary, lodge their disputes.

The procedures in four purchase agreements, however, specifically gave the party who was not responsible for preparing the calculation the right to respond.[392] The procedures in three of these agreements did not contain post-closing price-adjustment procedures.[393] Accordingly, a response period was appropriate to enable the nonpreparing party to dispute the submitted calculations before they became final. The procedures in the remaining purchase agreement allowed the nonpreparing party, in certain circumstances, to either cancel the agreement or agree to a maximum price adjustment amount upon review of the submitted calculations.[394]

Post-closing price-adjustment procedures were much more prevalent in the agreements we reviewed. Per above, 23 transactions contained post-closing price-adjustment procedures. Only 16 transactions, however, contained detailed timelines for the submission of post-closing calculations and the resolution of any resulting disputes.[395] These detailed timelines generally allowed the party preparing the calculations approximately 30 to 45 days to submit their calculations—with some allowing as many as 180 days and others allowing as few as three days.

Where a post-closing report was required under the price-adjustment procedures, 13 of the sale transactions analyzed required the purchaser to prepare the report.[396] Such procedures are consistent with the premise that the purchaser—with ready access to the books and records relating to the purchased assets—has greater capability to prepare the report after closing. There were, however, four agreements that required the seller to prepare the post-closing report.[397]

392 Where parties were permitted to respond to pre-closing reports, the response period was generally five business days.

393 *See* App. 3.1.3 (*Acme Metals*; *Cone Mills*; *Kaiser Aluminum (Tacoma sale)*).

394 *See* App. 3.1.3 (*Kellstrom*).

395 *See* App. 3.1.3 (*ABC-NACO*; *Am. Int'l Refinery*; *Asia Global Crossing*; *Bethlehem Steel*; *Burlington Indus.*; *Centis (consumer sale)*; *Enron (wind turbine business sale)*; *Ha-Lo*; *New Century; Northpoint Communications*; *Owens Corning*; *Peregrine*; *Safety-Kleen*; *TWA*; *U.S. Aggregates; Weld Wheel*).

396 *See* App. 3.1.3 (*ABC-NACO*; *Am. Int'l Refinery*; *Bethlehem Steel*; *Burlington Indus.*; *Centis (consumer sale)*; *Enron (wind turbine business sale)*; *K-Mart*; *New Century; Northpoint Communications*; *Owens Corning*; *Peregrine*; *TWA; Weld Wheel*).

397 *See* App. 3.1.3 (*Asia Global Crossing*; *Ha-Lo*; *Safety-Kleen*; *U.S. Aggregates*).

The procedures we reviewed did not provide a consistent accounting methodology for preparing the report. Several of the procedures required the preparing party to conform to generally accepted accounting principles (GAAP).[398] Others required the preparing party to use standards previously employed by the seller in preparing its financial statements, schedules or reports relating to the sale transaction.[399]

Once the preparing party submitted the initial calculations, the procedures generally allowed the nonpreparing party between 20 and 45 days to review and respond – though some allowed as many as 90 days and others allowed as few as 10 days. The party preparing the report was generally required to provide the other party with the documentation, books and records it used to do so.[400]

Upon completion of the review period, the procedures generally required the responding party to formally dispute either all or part of the report or otherwise consent to it becoming final and binding. A majority of the procedures we analyzed required a party to set forth in reasonable detail the basis for its dispute. Some even required the responding party to submit its own calculations.[401] Calculations that were not disputed were deemed binding upon the parties and, in some situations, the party liable for the price adjustment was required to remit payment for undisputed amounts even before all remaining disputes were resolved and the overall report became final.[402]

Where the responding party disputed one or more of the submitting party's calculations, the parties generally had 30 days to attempt to resolve the dispute amicably. The procedures in two of the agreements allowed for the extension of this period upon mutual agreement of the parties (which would be beneficial if the parties were hopeful that a compromise could be reached shortly after the expiration of the negotiation period). The procedures generally required the parties to cooperate using "good faith," "commercially reasonable" efforts or "best efforts" to resolve the disputes. Although none of the procedures we reviewed provided a consequence for failure to adhere to these standards of cooperation, parties should consider including

398 *See, e.g.*, App. 3.1.3 (*ABC-NACO*; *Ha-Lo*; *Peregrine*; *TWA*; *U.S. Aggregates; Weld Wheel*).

399 *See, e.g.*, App. 3.1.3 (*Asia Global Crossing*; *Burlington Indus.*; *Safety-Kleen*; *Teligent*; *TWA*).

400 Where the purchaser is responsible for preparing the report, it should consider including restrictions in the procedures limiting the seller's ability to investigate the report in a manner that would be obtrusive or disruptive to its operations. For example, in *Owens Corning*, the purchase agreement provided that the seller could investigate the report for 30 days, but had to do so in a way that will not "unreasonably interfere" with the purchaser's operations. *See* App. 3.1.3 (*Owens Corning*).

401 *See, e.g.*, App. 3.1.3 (*Bethlehem Steel*; *Burlington Indus.*; *Enron (wind turbine business sale)*).

402 *See, e.g.*, App. 3.1.3 (*Ha-Lo*; *Safety-Kleen*).

a provision requiring a noncooperating party to pay any formal dispute resolution fees incurred because of the parties' inability to resolve their dispute amicably.

Where parties were unable to resolve their disputes, the procedures generally provided for a third-party dispute resolution mechanism. The most commonly employed method of third-party resolution was the retention of an independent accounting firm.[403] The procedures contemplated that these firms would act as either experts or arbitrators, and their decisions would be final and binding upon the parties. Most procedures contemplated that the independent accounting firm would be permitted access to all books and records, and would independently calculate the amounts in question. Some procedures, however, required the accounting firm to render a decision for an amount falling within the bounds of calculations offered by the parties during their informal dispute process.[404] In two transactions, the procedures restricted the accounting firm from viewing any records other than those the parties submitted to one another as part of the informal resolution process.[405]

In selecting an independent accounting firm, the procedures generally required that the selected firm not have been involved with either party during the previous two years. Such a requirement is advisable to ensure that the accounting firm is not biased toward one side or the other.

Although unusual, some agreements contained procedures providing specific mechanisms for selecting an independent accounting firm when the parties otherwise could not agree. For example, in *Ha-Lo Industries*, the procedures provided that if the parties could not agree on an independent accounting firm, a "big four" firm would be drawn by lot. In *Peregrine*, the procedures provided that if the parties could not agree on an accounting firm, the firm's selection would be submitted to the American Arbitration Association for review and decision.

Where disputes were submitted to a third party for resolution, the procedures generally provided that the parties were to use their best efforts to ensure that the third party resolved the matter as soon as practicable or within approximately 30 days. The

403 In three of the purchase agreements, the parties were to take their disputes directly to the bankruptcy court for determination. *See* App. 3.1.3 (*ABC-NACO*; *Onsite Access*; *TWA*). In two of the purchase agreements, the parties were to submit their disputes to arbitration under the general arbitration clause contained in the purchase agreement. *See* App. 3.1.3 (*Kaiser Aluminum (Tacoma sale)*; *Northpoint Communications*). One of the purchase agreements required that the parties submit their disputes to a nationally recognized independent environmental consultant acceptable to both parties. *See* App. 3.1.3 (*Acme Metals*).

404 *See* App. 3.1.3 (*Bethlehem Steel*; *Enron (wind turbine business sale); Weld Wheel*).

405 *See* App. 3.1.3 (*Safety-Kleen; Weld Wheel*).

cost of the resolution was generally handled in three ways: (1) the costs were borne equally by the parties;[406] (2) the costs were borne by one party or the other;[407] or (3) the costs were borne in proportion to the sum of all amounts in dispute determined against each party.[408] The third method is seemingly the most fair, putting the burden of payment on the party who was incorrect in its calculations and likely reducing the number of unsubstantiated disputes.

3.2 Buyer Deposits

A deposit is an amount of consideration negotiated between the buyer and seller that serves, in part, as a testament to a buyer's willingness to engage in and be bound by the terms of a purchase agreement. Providing the deposit reassures the seller that the buyer is interested in completing that sale transaction. In addition, the deposit provides the seller with security for payment on account of damages arising from a buyer's breach of the purchase agreement. More often than not, the seller is entitled to keep a deposit as liquidated damages in the event that a buyer "wrongfully" terminates a sale transaction, but the deposit generally is refundable in whole or in part to the buyer if the sale does not close for any reason other than a breach of the purchase agreement by the buyer.

Appendix 3.2A is a summary of the language used in the sale transactions analyzed relating to the amount and timing of buyer deposits, whether or not such deposits were placed in escrow, and the amount of such deposits as a percentage of the estimated initial and final purchase prices for each sale transaction. Appendix 3.2B is a summary of the language used in the sale transactions analyzed relating to the conditions under which a deposit is refunded to the buyer and/or seller, as applicable.

In general, of the 60 sale transactions analyzed, 39 (or approximately two-thirds) included a deposit requirement.[409] Among these 39 sale transactions, however, there

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406 *See, e.g.*, App. 3.1.3 (*Acme Metals*; *Centis (consumer sale)* (but seller's liability for costs capped at $75,000); *Enron (wind turbine business sale)*; *New Century; Peregrine*; *Safety-Kleen*).

407 *See, e.g.*, App. 3.1.3 (*Bethlehem Steel*; *Northpoint Communications*).

408 *See, e.g.*, App. 3.1.3 (*Burlington Indus.*; *Ha-Lo*; *Owens Corning*; *U.S. Aggregates; Weld Wheel*).

409 *See* App. 3.2A (*ABC-NACO*; *Acme Metals*; *Am. Int'l Refinery*; *Asia Global Crossing*; *Bethlehem Steel*; *Cable & Wireless*; *Calpine Corp. (Dighton sale); Calpine Corp. (Fremont sale); Centis (consumer sale)*; *Centis (G. Neil sale)*; *Chevys*; *Daisytek*; *Diamond Brands*; *Divine*; *e.spire Communications (Cybergate sale)*; *e.spire Communications (Xspedius sale)*; *Easy Gardener Products; Enron (Bridgeline sale)*; *H & S Media*; *Ha-Lo*; *Int'l Fibercom*; *Iridium*; *Kaiser Aluminum (Kaiser Center sale)*; *Kaiser Aluminum (Tacoma sale)*; *Kellstrom*; *K-Mart*; *Metromedia Fiber*;

is a wide variance in the size and form of the deposits, when and how the deposits are paid, and under what circumstances and when the deposits may be refunded to the buyer, all discussed in greater detail below. Based on the sale transaction analysis, the terms governing a buyer's deposit are deal-specific and do not correlate with any particular jurisdiction, judge, transaction size or industry. Rather, the terms of a buyer's deposit appear to be negotiated on a case-by case basis, and differ significantly even between separate sales conducted in the same bankruptcy case.[410]

Of the remaining 21 sale transactions that did not contain any buyer deposit requirements per the terms of the applicable purchase agreement,[411] seven contained provisions in the bidding procedures order that arguably would require the stalking-horse purchaser, as well as any other bidders bidding at the auction, to provide a deposit (generally either 5 percent or 10 percent of the bid) in order to participate in the auction process.[412] One transaction (*Werner Holding*) did not require a deposit, but did require a $7 million buyer termination fee payable to the seller by the buyer in the event that the seller terminated the purchase agreement on specified bases. Although 13 of the sale transactions did not contain any buyer deposit requirement in either the purchase agreement or the bidding procedures order,[413] purchasers in at least two of those sale transactions provided debtor-in-possession financing to the debtor-seller pending closing of the sale transaction.[414] Thus, a buyer willing to provide debtor-in-possession financing can demonstrate its commitment to the sale transaction through such financing (which the debtor-seller will need to continue operations and preserve

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Network Plus; *New Century; Northpoint Communications*; *Owens Corning*; *Republic Engineered*; *Ritter Ranch*; *Rouge*; *RSL Com Primecall*; *Russian Tea Room*; *Teligent*; *U.S.Gen New England; Weld Wheel*).

410 *See* App. 3.2A (*Compare e.spire Communications (Cybergate sale) with e.spire Communications (Xspedius sale)*. *Compare Enron (Bridgeline sale)* (deposit requirement) *with Enron (wind turbine business sale)* (no deposit requirement). *Compare Kaiser Aluminum (Kaiser Center sale) with Kaiser Aluminum (Tacoma sale)*).

411 It should be noted that Section 3.2 is intended only to address the analysis of buyer deposit requirements as set forth in the applicable purchase agreements. Even though a purchase agreement itself may be silent on deposit requirements, in a 363 sale, the order establishing bidding procedures nonetheless could provide a blanket requirement that all bidders (which by implication may include the initial stalking-horse bidder) make a deposit in order to participate in the auction process. Section 5.5 sets forth a more detailed discussion and analysis of deposit requirements for qualified bidders.

412 *See* App. 3.2A (*Burlington Indus.* (requiring 5 percent deposit); *Cone Mills* (requiring 10 percent deposit); *Integrated Telecom Express* (requiring $100,000 deposit, *i.e.*, 5 percent deposit); *Nextwave Pers. Communications* (requiring 1.5 percent deposit); *Onsite Access* (requiring $500,000 deposit, *i.e.*, 10 percent deposit); *Pillowtex* (requiring 10-15 percent deposit); *Velocita* (requiring 5 percent deposit)).

413 *See* App. 3.2A (*ANC Rental (Midwest sale)*; *ANC Rental (Dunworth sale)*; *Brac Group*; *Clarent*; *Enron (wind turbine business sale)*; *Gayley & Lord*; *Kenny*; *M. Fabrikant & Sons; Orbcomm Global*; *Peregrine*; *Safety-Kleen*; *TWA*; *U.S. Aggregates*).

414 *See* App. 3.2A (*Peregrine* (providing $110 million debtor-in-possession financing facility); *TWA* (providing debtor-in-possession financing, a portion of which—*i.e.*, the greater of $50 million or 10 percent of the cash portion of the bid—would not be repaid by the seller to the purchaser upon breach of the purchase agreement by purchaser)).

the going-concern value of its business pending consummation of a sale), and does not need to provide an additional deposit.

3.2.1 Size, Form and Timing of Deposit

In most sale transactions (both in and out of bankruptcy), a buyer and seller will negotiate a percentage of the overall purchase price to serve as a deposit in the sale transaction. These deposits are typically in the form of cash, check, wire transfer, a guarantee from an affiliate or a letter of credit payable in whole to a designated account. A small number of sale transactions analyzed (seven) required that the deposits be paid in stages or tranches.[415]

Of the transactions analyzed that included a deposit, the amounts of the deposits ranged from approximately $5,000 to approximately $17.7 million depending, in part, on the overall size of the sale transaction. When calculated as a percentage of the initial purchase price, such deposits ranged from approximately 1 percent to 100 percent of the purchase price,[416] with the average deposit being approximately 7.4 percent of the initial purchase price (excluding the two transactions requiring 100 percent deposits) or approximately 12.15 percent of the initial purchase price (including the two transactions requiring 100 percent deposits).

Less than one-half of the deposits (16 out of the 39) provided for deposits in a range equal to or greater than 1 percent but less than 5 percent of the purchase price.[417]

415 *See* App. 3.2A (*Calpine Corp. (Dighton sale); Calpine Corp. (Fremont sale); Chevys*; *Iridium*; *Kaiser Aluminum (Kaiser Center sale)*; *Owens Corning*; *U.S.Gen New England*).

416 With respect to calculating the deposit as a percentage of the initial purchase price, it should be noted that the percentages were calculated compared to the estimated overall consideration of the transaction, and not just the cash portion of the purchase price. However, the calculations of the overall consideration are merely approximations of cash and noncash consideration as stated in the purchase agreements and do not include (1) any consideration that is not quantifiable per the terms of the applicable purchase agreement (such as, but not limited to, unquantifiable assumed liabilities, equity and debtor-in-possession financing obligations), and (2) any adjustments to the purchase price set forth in the applicable purchase agreement. In addition, the deposit percentages may be significantly greater when compared only to the cash portion of the purchase price. For example, in *Republic Engineered*, the deposit as a percentage of the cash portion of the initial purchase price is approximately 10 percent, whereas such percentage is only 5.4 percent when compared to the overall consideration paid under the purchase agreement.

417 *See* App. 3.2A (*ABC-NACO* (approximately 4.6 percent deposit); *Acme Metals* (approximately 4.6 percent deposit); *Am. Int'l Refinery* (approximately 2.5 percent deposit); *Asia Global Crossing* (approximately 4.5 percent deposit); *Bethlehem Steel* (approximately 1 percent deposit); *Chevys* (approximately 1 percent deposit); *Daisytek* (approximately 1.6 percent deposit); *e.spire Communications (Xspedius sale)* (approximately 1.7 percent deposit); *Int'l Fibercom* (approximately 4.9 percent deposit); *Kaiser Aluminum (Kaiser Center sale)* (approximately 4.7 percent deposit); *Kaiser Aluminum (Tacoma sale)* (approximately 3.1 percent deposit); *Metromedia Fiber* (approximately 3.6 percent deposit); *Northpoint Communications* (approximately 1 percent deposit); *Owens Corning* (approximately 4 percent deposit); *Rouge* (approximately 2.2 percent deposit); *U.S.Gen New England* (approximately 4 percent deposit)).

Fifteen of the remaining deposits ranged from 5 percent to equal or less than 10 percent,[418] and the remaining six deposit amounts ranged from greater than 10 percent but equal to or less than 25 percent.[419] Only two of the transactions required that the buyer deposit 100 percent of the purchase price, which may be explained, at least in part, by the small size of the transactions – $0.4 million and $16 million respectively – and by the fact that the $16 million transaction required the purchaser to post an unconditional, irrevocable letter of credit (rather than paying a cash deposit).[420]

1 percent to 4.9 percent	5 percent to 10 percent	10.01 percent to 25 percent	100 percent
16	15	6	2

The deposits as a percentage of the initial purchase price also varied significantly by jurisdiction. For example, in the U.S. Bankruptcy Courts for the Central District of California, Northern District of California, District of Delaware, Northern District of Illinois and Southern District of New York, the deposits, as a percentage of the overall purchase price, varied as follows:

Jurisdiction	No Deposit	1 percent to 4.9 percent	5 percent to 10 percent	Greater than 10 percent
California (C.D.)	0	0	2	1
California (N.D.)	1	2	0	0
Delaware	11	6	7	0
Illinois (N.D.)	1	0	2	1
New York	4	3	4	3

418 *See* App. 3.2A (*Cable & Wireless* (approximately 10 percent deposit); *Calpine Corp. (Dighton sale)* (approximately 10 percent deposit); *Calpine Corp. (Fremont sale)* (approximately 10 percent deposit); *Centis (consumer sale)* (approximately 6.5 percent deposit); *Centis (G. Neil sale)* (approximately 10 percent deposit); *Diamond Brands* (approximately 7.7 percent deposit); *e.spire Communications (Cybergate sale)* (approximately 6 percent deposit); *Easy Gardener Products* (approximately 10 percent deposit); *Enron (Bridgeline sale)* (approximately 10 percent deposit); *H & S Media* (approximately 10 percent deposit); *Ha-Lo* (approximately 7.6 percent deposit); *Iridium* (approximately 6 percent deposit); *Kellstrom* (approximately 9 percent deposit); *New Century* (approximately 7.2 percent deposit); *Republic Engineered* (approximately 5.4 percent deposit)).

419 *See* App. 3.2A (*Divine* (approximately 25 percent deposit); *K-Mart* (approximately 12 percent deposit); *Network Plus* (approximately 12.5 percent deposit); *Ritter Ranch* (approximately 20 percent deposit); *RSL Com Primecall* (approximately 16.8 percent deposit); *Weld Wheel* (approximately 14.7 percent deposit)).

420 *See* App. 3.2A (*Russian Tea Room*; *Teligent*).

In addition, a buyer may pay a deposit at any time during the sale transaction process: It can be tied to execution of the purchase agreement, entry of a court order (such as the bidding-procedures order), or a specified date or event (such as approval of a plan of reorganization). Of the transactions analyzed, payment of a deposit correlated most to execution of the purchase agreement.[421] In two instances, the deposit was required to be paid on a specific date.[422]

3.2.2 Escrows and Deposit Accounts

From a buyer's perspective, it is typically more favorable to require that the deposit be held by an independent third party, such as an escrow agent, rather than by the debtor-seller. Although this may increase the parties' transaction costs, which may not be practical or desirable with smaller transactions, using a third-party agent reduces the risk of the debtor commingling the deposit with other funds of the estate (and thus creating future "property of the estate" issues with respect to the deposit). Prohibiting the debtor-seller from holding the deposit also allows the buyer to retain more control (or at least control equal to that of the debtor-seller) over the disposition of the deposit.

Of the 39 sale transactions that contained deposit provisions, more than one-half (22) provided for formalized escrow agreements to govern the deposit.[423] Ten provided for deposits to be held by the debtor-seller without the need for a formalized escrow agreement, typically in a segregated account maintained by the debtor-seller in the case of a cash deposit, or in the form of a guarantee or letter of credit.[424] Seven provided for the deposits to be held by the debtor-seller's counsel (typically acting in the capacity of an "escrow agent").[425] The presence or lack of a formalized escrow agreement does not seem to correlate to the size of the deposit or the sale transaction, nor does it correlate with any particular jurisdiction, judge or industry.

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421 Five of the sales transactions analyzed required deposits to be paid shortly after execution of the purchase agreement, four required payment prior to execution of the purchase agreement, and 15 required payment concurrent with execution of the purchase agreement.

422 *See* App. 3.2A (*Iridium*; *Network Plus*).

423 *See* App. 3.2A (*ABC-NACO*; *Acme Metals*; *Am. Int'l Refinery*; *Bethlehem Steel*; *Cable & Wireless*; *Calpine Corp. (Dighton sale); Calpine Corp. (Fremont sale); Enron (Bridgeline sale)*; *Int'l Fibercom*; *Kaiser Aluminum (Kaiser Center sale)*; *Kaiser Aluminum (Tacoma sale)*; *Kellstrom*; *Network Plus*; *New Century; Owens Corning*; *Republic Engineered*; *Ritter Ranch*; *Rouge*; *Teligent*; *U.S.Gen New England; Weld Wheel*).

424 *See* App. 3.2A (*Asia Global Crossing*; *Centis (consumer sale)*; *Centis (G. Neil sale)*; *Chevys*; *Diamond Brands*; *H & S Media*; *Ha-Lo*; *K-Mart*; *Metromedia Fiber*; *Northpoint Communications*).

425 *See* App. 3.2A (*Daisytek*; *Divine*; *e.spire Communications (Cybergate sale)*; *e.spire Communications (Xspedius sale)*; *Iridium*; *RSL Com Primecall*; *Russian Tea Room*). It should be noted that for liability purposes, many law firms will not act as an escrow agent or otherwise hold deposits for clients as part of a sale transaction.

Although most of the deposit provisions analyzed required that the deposit be held in some form of deposit account, either pursuant to an escrow agreement or not, surprisingly few of the asset-purchase agreements addressed the issue of interest earned on such deposits.[426] Less than one-third of the relevant provisions analyzed (*i.e.*, 14) discussed interest paid on a deposit or the disposition of such interest amounts. Of those that did, all but two provided that interest paid on the deposit be applied toward the eventual purchase price, thus reducing the amount that a buyer eventually would have to pay upon the close of the sale transaction.[427] The other two transactions discussed the interest component only as it related to the payment of liquidated damages and not with respect to a "reduction" in the purchase price.[428] Also surprising was the lack of detail as to who would bear the costs associated with an escrow or deposit account: Only three sale transactions specifically detailed that the buyer would bear the cost of the account.[429]

Deposits in the form of a guarantee or letter of credit, instead of cash, although carrying some transaction costs, automatically include a third-party control mechanism and may eliminate the need to include provisions that deal with interest. If the deposit is not in the form of a guarantee or letter of credit, a buyer should strongly consider including detailed provisions in the purchase agreement or other ancillary document related to the deposit account, including deposit in an interest-bearing account, who is to be entitled to the interest and under what circumstances, and who bears the costs and expenses associated with the deposit account.

In addition, to minimize a buyer's risk in the event that the deposit is refunded to the buyer, the purchase agreement should specify that the deposit is excluded from property of the debtor-seller's estate.[430] Surprisingly, only two purchase agreements included provisions specifically excluding the deposit from property of the debtor-seller's estate.[431] Providing for such exclusion is desirable for buyers because it may aid in any future disputes regarding ownership of the deposit and may simplify

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426 It should be noted that our analysis did not include a review of the applicable escrow agreements to the extent that such agreements were ancillary documents to the purchase agreements. Thus, although a purchase agreement may not have addressed the issue of interest on a deposit, the applicable escrow agreement, to the extent one existed, most likely addressed the issue of interest in more detail.

427 *See generally Am. Int'l Refinery*; *Calpine Corp. (Dighton sale); Easy Gardener Products; H & S Media*; *Ha-Lo*; *Kaiser Aluminum (Kaiser Center sale)*; *Kaiser Aluminum (Tacoma sale)*; *K-Mart*; *New Century; Ritter Ranch*; *Rouge*; *Russian Tea Room*.

428 *See generally Int'l Fibercom*; *Iridium*.

429 *See* App. 3.2A (*Am. Int'l Refinery*; *Cable & Wireless*; *Ha-Lo*).

430 A buyer also should consider contribution of deposits in stages or tranches tied to incremental achievements or occurrences in the bankruptcy case.

431 *See* App. 3.2A (*Chevys*; *Metromedia Fiber*).

return procedures in the event the sale transaction is not consummated. Because most deposits are not intended to be property of the estate prior to a breach of the purchase agreement by the buyer, explicitly providing such in the purchase agreement should not be controversial.

3.2.3 Refunding Buyer Deposits

Appendix 3.2B is a summary of the language used in the sale transactions analyzed relating to the circumstances under which buyer deposits are refunded. In the event that a sale transaction is not completed, all but one of the purchase agreements that included a provision regarding deposits also included a provision regarding the circumstances under which such deposits must be refunded to the buyer or deemed earned by the seller (the exception being *Asia Global Crossing*).

Only 16 of the 38 refund provisions, however, addressed the timing of such refund, typically requiring that the deposit be paid to the buyer "promptly," "immediately" or within 2-10 business days after termination of the purchase agreement or other written demand.[432] Some purchase agreements also required the buyer to take affirmative action to receive the refund, such as written demand to the seller or notice to the escrow agent.[433]

Most of the purchase agreements provided that unless a buyer breaches its obligations under the purchase agreement, which breach is either material and/or results in a termination of the purchase agreement, the deposit shall be returned to the buyer.[434] Other purchase agreements allowed the seller to keep the deposit under specified circumstances or required the seller to return the deposit under specified circumstances (including failing to get bankruptcy court approval of the bidding procedures and/or the sale transaction by a date certain), typically in addition to the obligation to retain or return a deposit based on termination due to a breach. Only

432 *See* App. 3.2B (*ABC-NACO* ("promptly upon demand"); *Bethlehem Steel* (within 2 business days after termination); *Daisytek* ("promptly instruct the Escrow Agent"); *Divine* ("immediately following such termination"); *e.spire Communications (Cybergate sale)* ("promptly upon the conclusion of the Auction" or within 5 business days of termination, as applicable); *H & S Media* (promptly upon termination); *Iridium* (within 10 business days after receipt by the Escrow Agent of notice); *Metromedia Fiber* (five days' notice before a party can withdraw the funds); *Northpoint Communications* (promptly after termination); *Republic Engineered* (within two business days after termination); *Ritter Ranch* ("immediately" if closing fails to occur); *Rouge* (within two business days after termination); *RSL Com Primecall* ("promptly," "immediately" or within five business days after notice, as applicable); *Russian Tea Room* (after10-business-day notice period); *U.S.Gen New England* (upon termination); *Weld Wheel* ("immediately" after termination)).

433 *See* App. 3.2B (*ABC-NACO*; *Daisytek*; *Iridium*; *Metromedia Fiber*; *RSL Com Primecall*; *Russian Tea Room*).

434 For example, *see* App. 3.2B (*Network Plus*).

two purchase agreements provided that a deposit shall be returned to a buyer under any circumstance,[435] and at least one purchase agreement specified that, unless the debtor-seller breached the purchase agreement, the buyer lost the deposit.[436]

The purchase agreements analyzed typically were very thorough in specifying the circumstances under which a deposit is returned. From a buyer's perspective, however, a catch-all provision providing that the deposit shall be returned to the buyer under any additional circumstances not already specified in the purchase agreement (such as the ones found in *H&S Media* and *U.S.Gen New England*) may further assist a buyer in the event of any inadvertent ambiguities.

3.3 Limitations on Seller's Recourse to Buyer

As a potential purchaser of assets of a bankrupt entity, a buyer should consider negotiating a limitation on the debtor-seller's ability to seek recourse against the buyer in the event that the buyer breaches its obligations under the purchase agreement. In other words, a buyer should attempt to protect itself from liability for hundreds of thousands (or possibly millions) of dollars' worth of damage arising from its breach of a purchase agreement, especially where the seller's business is at a higher risk due to the pending bankruptcy and its financial condition that led to the bankruptcy filing. Such limitations on recourse can take many forms, including providing that the parties agree to no damages in the event of termination, limiting those damages to the deposit paid by the buyer, limiting the type of damages that a seller can assert against a buyer, limiting or allowing for specific performance or injunctive relief remedies, or any combination of the foregoing.

Appendix 3.3 is a summary of the language used in the sale transactions analyzed regarding limitations placed on a seller seeking recourse against a buyer who breaches one or more provisions of a purchase agreement. Of the 60 sale transactions analyzed, over two-thirds of the sale transactions, or 43 in total, contained language in the purchase agreement addressing limitations (or the lack thereof) placed on sellers seeking recourse against a buyer.[437] Based on the sale transaction analysis,

435 *See* App. 3.2B (*Acme Metals*; *Bethlehem Steel*).

436 *See* App. 3.2B (*H & S Media*).

437 *See* App. 3.3 (*Am. Int'l Refinery*; *Bethlehem Steel*; *Brac Group*; *Burlington Indus.*; *Cable & Wireless*; *Centis (G. Neil sale)*; *Calpine Corp. (Dighton sale); Calpine Corp. (Fremont sale); Chevys*; *Daisytek*; *Diamond Brands*; *Divine*; *e.spire Communications (Cybergate sale)*; *Easy Gardener Products; Enron (Bridgeline sale)*; *Enron (wind turbine*

the terms governing limitations on recourse against buyers are deal-specific, and do not correlate with any particular jurisdiction, judge, transaction size, or industry. Rather, such limitations appear to be negotiated on a case-by case basis, and differ significantly even between separate sales conducted in the same bankruptcy case.[438]

Four of the 43 sale transactions explicitly provided that there were no limitations on a seller's recourse against a buyer, and that the seller was permitted to pursue all available remedies in law and equity against the buyer.[439] In addition to these four, the 20 transactions that did not address any limitation on a seller's recourse against the buyer create an inference that the seller may pursue all remedies.

Eighteen out of the 36 that provided some form of limitation on a seller's recourse against a buyer, limited the seller's recourse against the buyer to the deposit paid by the buyer (or some portion thereof) as the seller's sole and exclusive remedy.[440] In three other cases where the buyer did not provide a deposit, the seller was limited to: in the *Velocita* case, damages not to exceed 5 percent of the purchase price; in the *Onsite Access* case, damages not to exceed the loan amount advanced by the buyer under Bankruptcy Code §364; and, in the *Werner Holding* case, damages in the amount of the $7 million buyer termination fee.[441] One of the sale transactions, in the *Ha-Lo Industries* case, limited the seller's recourse against the buyer to damages in an amount not to exceed $3 million (where the deposit was only $1.06 million) in the event of certain breaches by the buyer, although the purchase agreement had a subsequent remedies provision providing, in relevant part, that "[a]ll rights and remedies of either party hereto are cumulative of each other and of every other right or remedy such party may otherwise have at law or in equity, and the exercise of one or more rights or remedies shall not prejudice or impair the concurrent or subsequent

business sale); *H & S Media*; *Ha-Lo*; *Int'l Fibercom*; *Iridium*; *Kaiser Aluminum (Kaiser Center sale)*; *Kaiser Aluminum (Tacoma sale)*; *Kellstrom*; *Kenny*; *Metromedia Fiber*; *Network Plus*; *New Century; Nextwave Pers. Communications*; *Northpoint Communications*; *Onsite Access*; *Owens Corning*; *Pillowtex*; *Republic Engineered*; *Ritter Ranch*; *Rouge*; *RSL Com Primecall*; *Russian Tea Room*; *Safety-Kleen*; *Teligent*; *U.S.Gen New England*; *Velocita; Weld Wheel; Werner Holding*).

438 *See, e.g.*, App. 3.3 (*Compare Centis (consumer sale)* (no provisions) *with Centis (G. Neil sale)* (limiting recourse to deposit amount). *Compare e.spire Communications (Cybergate sale)* (limiting recourse to deposit amount) *with e.spire Communications (Xspedius sale)* (no provisions). *Compare Enron (Bridgeline sale)* (limiting recourse to deposit amount and obligations that survive termination of the purchase agreement, and limiting the scope of the type of damages) *with Enron (wind turbine business sale)* (limiting the scope of the type of damages).

439 *See* App. 3.3 (*Burlington Indus.*; *Daisytek*; *Iridium*; *RSL Com Primecall*).

440 *See* App. 3.3 (*Am. Int'l Refinery* (seller entitled only to partial deposit); *Centis (G. Neil sale)*; *Chevys*; *Diamond Brands*; *e.spire Communications (Cybergate sale)*; *Enron (Bridgeline sale)*; *H & S Media*; *Int'l Fibercom*; *Kaiser Aluminum (Kaiser Center sale)*; *Kellstrom*; *Northpoint Communications*; *Owens Corning*; *Republic Engineered*; *Ritter Ranch*; *Rouge*; *Russian Tea Room*; *U.S.Gen New England; Weld Wheel*).

441 *See* App. 3.3.

exercise of other rights or remedies." This cumulative remedies provision leaves ambiguous whether the buyer's exposure for breach would in fact be limited to recovery of money damages in an amount not to exceed $3 million.

Even among the sale transactions that limited the seller's right of recourse to the buyer's deposit or other specified amount as the seller's sole and exclusive remedy, the language establishing this limitation varied significantly, with some sale transactions being more explicit (*i.e.*, buyer-friendly) than others.[442]

Three of the sale transactions allowed the seller to pursue equitable remedies against the buyer or, in the alternative, damages against the buyer in an amount not to exceed the buyer's deposit amount.[443] Four other sale transactions specified that the seller could pursue all remedies at law against the buyer in the event of breach, with no limitation on damages, but did not provide for any equitable relief.[444]

Only one sale transaction, in the *Teligent* case, specified that the seller would not be entitled to any damages in the event of a breach, but only the right to terminate the agreement. This provision (and the strong pro-buyer limitation language), however, most likely is explained by the small size of the sale transaction (*i.e.*, approximately $400,000). Another sale transaction, in the *Kenny Industrial Services* case, provided a release of all claims and damages for the buyer's breach (leaving only a right by the seller to terminate the purchase agreement). Unlike the *Teligent* case, however, the *Kenny Industrial Services* provision excluded breaches based on the buyer's failure to perform its obligations under the purchase agreement, among other things. One other sale transaction, in the *Brac Group* case, specified that the seller could seek specific performance or termination, but not any damages, on account of a buyer's breach. The parties in the *Brac Group* sale transaction also had negotiated that the buyer did not have to provide a deposit to the seller.

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442 *See* App. 3.3 (*Compare Int'l Fibercom* ("If this Agreement is validly terminated by IFCI pursuant to Section 8.04(a)(ii), the Initial Deposit, together with all interest and earnings thereon, shall be paid to Sellers as liquidated damages and not as a penalty and as Seller's sole remedy, in lieu of any other claim, right or remedy against Buyer, Buyer and Sellers having agreed that the amount of the Initial Deposit represents a reasonable endeavor on the part of the Parties to ascertain a sum which would represent the damage suffered by Sellers in the event that Buyer fails or is unable to close the Transaction.") *with Velocita* ("[I]f Seller terminates this Agreement as a result of Buyer's material breach of its obligations under this Agreement or its failure to close by November 30, 2002 through the sole fault of Buyer, Buyer shall pay to Seller an amount equal to five percent (5 percent) of the Purchase Price as liquidated damages.")).

443 *See* App. 3.3 (*Cable & Wireless*; *Kaiser Aluminum (Tacoma sale)*; *Metromedia Fiber*).

444 *See* App. 3.3 (*Bethlehem Steel*; *Divine*; *Network Plus*; *Safety-Kleen*).

Although most of the 43 sale transactions that contained language regarding limitations on recourse against a buyer addressed recourse resulting from a pre-closing breach by the buyer, some of the sale transactions also specified limitations on recourse against a buyer based on post-closing breaches.[445] The recourse against a buyer based on a post-closing breach typically was limited to any post-closing indemnity provisions in the purchase agreement.

Many of the sale transactions that limited a seller's recourse against a buyer nonetheless contained certain carve-outs, the most notable of which consisted of: (1) carve-outs for fraud, willful misconduct or other similar misconduct (*i.e.*, there were no limitations placed on a seller's recourse against a buyer's breach based on fraud or willful misconduct of the buyer);[446] and (2) carve-outs for any obligations that survived the termination of the purchase agreement (for example, on account of post-termination breaches of confidentiality obligations).[447] Twelve of the sale transactions also contained explicit provisions limiting the type of damages that a seller could recover against a buyer, such as prohibiting consequential or punitive damages.[448]

Other notable provisions contained in the sale transactions that affected a buyer's liability in the event of a breach included:

- provisions allowing a seller to collect attorneys' fees;[449]
- provisions expressly prohibiting any recourse against the buyer's affiliates, directors, officers, shareholders, members, managers, employees, trustees, beneficiaries, agents, attorneys, representatives and contractors, or their successors and assigns;[450]

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445 *See* App. 3.3 (*Burlington Indus.; Cable & Wireless; Ha-Lo; Metromedia Fiber; Nextwave Pers. Communications; Owens Corning; Pillowtex)*. These type of provisions are most appropriate where the parties have negotiated for survival of certain representations and warranties. *See* discussion *infra* Section 6.1.2.

446 *See* App. 3.3 (*Burlington Indus.*; *Diamond Brands*; *Enron (Bridgeline sale)*; *Kenny*; *Nextwave Pers. Communications*; *Owens Corning*; *Rouge*; *Teligent*; *U.S.Gen New England*).

447 *See* App. 3.3 (*Enron (Bridgeline sale)*; *Kaiser Aluminum (Tacoma sale)*; *Kenny*; *Northpoint Communications*; *Rouge*; *Russian Tea Room*).

448 *See* App. 3.3 (*Calpine Corp. (Dighton sale); Calpine Corp. (Fremont sale); Easy Gardener Products; Enron (Bridgeline sale)*; *Enron (wind turbine business sale)*; *Kaiser Aluminum (Tacoma sale)*; *Metromedia Fiber*; *New Century; Northpoint Communications*; *Onsite Access*; *Pillowtex*; *U.S.Gen New England*).

449 *See* App. 3.3 (*Kaiser Aluminum (Kaiser Center sale)*; *Kaiser Aluminum (Tacoma sale)*).

450 *See* App. 3.3 (*Kaiser Aluminum (Tacoma sale); New Century*).

- provisions waiving the right to rescission once the sale transaction closed;[451]

- provisions prohibiting any recourse by the seller against the buyer for breaches the seller knows about prior to consummation of the sale transaction, if the seller nonetheless agrees to consummate the sale;[452]

- provisions that allow the seller to collect the greater of the deposit or actual damages in the event that the buyer interferes with the seller's collection of the deposit upon buyer's breach of the purchase agreement;[453]

- provisions establishing both minimum and maximum limitations on a buyer's liability;[454] and

- provisions that increase the amount of liquidated damages recoverable by the seller in stages based on certain events in the purchase agreement.[455]

As evidenced by the multiple variations on limitations on a seller's recourse against a buyer set forth in the 60 sale transactions analyzed, these types of provisions appear to be heavily negotiated by the parties. Given the financial instability of some debtor-sellers, buyers purchasing assets in a 363 sale should pay close attention to these types of provisions.

451 *See* App. 3.3 (*Enron (wind turbine business sale)*; *Kaiser Aluminum (Tacoma sale)*).
452 *See* App. 3.3 (*Kaiser Aluminum (Tacoma sale)*).
453 *See* App. 3.3 (*Kaiser Aluminum (Kaiser Center sale)*).
454 *See* App. 3.3 (*Pillowtex*).
455 *See* App. 3.3 (*Kaiser Aluminum (Kaiser Center sale)*).