U.S. BANKRUPTCY COURT
District of South Carolina

Case Number: 03-08807W

The relief set forth on the following pages, for a total of 5 pages including this page, is hereby **ORDERED**.

FILED BY THE COURT ON

October 16, 2003

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

John E. Waites
John E. Waites
US Bankruptcy Court Judge
District of South Carolina

ENTERED

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

In re:	)	
	)	
Paintball, Inc.,	)	Case No. 03-08807-W
	)	Chapter 11
Debtor.	)	
	)	

ORDER DENYING APPROVAL OF BREAK-UP FEE AND MOTION TO INCUR POST-PETITION DEBT

THIS MATTER is before the Court on motion of the debtor-in-possession for an Order allowing it to enter into a secured post-petition financing arrangement with Accucaps Industries, Limited ("Accucaps") and for approval of a break up fee. Accucaps is an unsecured creditor of the debtor-in-possession and has offered to purchase the debtor's "fixed assets", inventory, and "intangibles", other than accounts receivable and causes of action, for the sum of One Million ($!,000,000.00) Dollars. The proposed financing arrangement provides a Three Hundred Thousand ($300,000.00) Dollar line of credit to maintain the inventory and going concern value of the debtor-in-possession pending the sale. Accucaps also seeks approval of the payment of One Hundred Fifty Thousand ($150,000.00) Dollars to it in the event that Paintball, Inc. sells its assets to a party other than Accucaps (the "break-up fee"). The United States Trustee and Nelson Technologies, Inc.("Nelson"), an unsecured creditor, have objected. At the commencement of the hearing, Accucaps and the debtor announced that they were reducing the requested break-up fee to Seventy-five thousand ($75,000.00) Dollars. The United States Trustee and Nelson maintained the objections. SouthTrust Bank is the debtor-in-possession's primary secured lender and its security interest would be subject to the Accucaps security

interest.

A break-up, topping fee or termination fee is a type of bidding incentive designed to encourage potential purchasers to bid for assets. "Agreements to provide breakup fees or reimbursement of fees and expenses are meant to compensate the potential acquirer who serves as a catalyst or 'stalking horse' which attracts more favorable offers." *In re S.N.A. Nut Company*, 186 B.R. 98, 101 (Bankr. N.D. Ill. 1995) (quoting *In re Marrose Corp.*, 1992 WL 33848, 5 (Bankr. S.D. N.Y. 1992). The courts are divided in applying the business judgment rule and an administrative expense analysis to the propriety of break-up fees. *See In re 995 Fifth Avenue Associates, L.P.*, 96 B.R. 24, 28 (Bankr. S.D. N.Y. 1989) and *In re O'Brien Environmental Energy, Inc.*, 181 F.3d 527 (3d Cir. 1999).

Regardless of the analytical approach taken[1] the break-up fee will not be approved in this case. While the break-up fee was reduced at the commencement of the hearing from fifteen percent (15%) to seven and one-half percent (7.5%) of the initial purchase offer, the fee is excessive. The Court reviews the amount of a proposed break-up fee on a case by case basis. A break-up fee, when permitted at all, of some lesser percentage seems proper, absent other compelling circumstances. *See In re Twenver, Inc.*, 149 B.R. 954, 957 (Bankr. D. Colo. 1992) (denying a break-up fee of $50,000 in connection with a purchase price of $450,000); *In re*

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[1] *In re Hupp Industries, Inc.*, 140 B.R. 191, 194 (Bankr. N.D. Ohio 1992) provides a useful list of factors to consider in evaluating a break-up fee request: 1) Whether the fee requested correlates with a maximization of value to the debtor's estate; 2) Whether the underlying negotiated agreement is an arms-length transaction between the debtor's estate and the negotiating acquirer; 3) Whether the principal secured creditors and the official creditors committee are supportive of the concession; 4) Whether the subject break-up fee constitutes a fair and reasonable percentage of the proposed purchase price; 5) Whether the dollar amount of the break-up fee is so substantial that it provides a "chilling effect" on other potential bidders; 6) The existence of available safeguards beneficial to the debtor's estate; and 7) Whether there exists a substantial adverse impact upon unsecured creditors, where such creditors are in opposition to the break-up fee.

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Integrated Resources, Inc., 135 B.R. 746 (Bankr. S.D. N.Y. 1992), *aff'd*, 147 B.R. 650 (S.D. N.Y. 1992)(the court heard expert testimony that the industry standard on average is 3.3% and ultimately approved a break-up fee that was 1.6% of the purchase price). A break-up fee is not subject to the easy application of a range of percentages. The important considerations in arriving at a reasonable break-up fee include the purchase price, the need to stimulate bidding by an initial offer, the cost of investigation that must be bourne by a potential purchaser, and the ratio of the potential value of the property to be acquired to the cost of acquisition.

The break-up fee proposed by Accucaps in connection with its offer to purchase assets for One Million ($1,000,000) Dollars is Seventy-five Thousand ($75,000) Dollars, reduced from the original One Hundred-Fifty Thousand ($150,000) Dollars. The proffer of evidence at the hearing on this matter did not reflect significant efforts to market the debtor's assets. A letter of intent between the debtor-in-possession and Accucaps relating to the purchase actually restricts the activities of the debtor-in-possession, its principals, and the secured lender, at least for some period of time, in seeking other offers for the property and requires that all unsolicited offers be reported to Accucaps. This prohibition stands opposed to a subsequent contradictory paragraph permitting the debtor-in-possession to seek other offers after the date of the letter of intent and before the Court approves the sale. Also a consideration for the Court in assessing the need to stimulate bidding for the assets is the provision that two of the key employees of the debtor-in-possession are to be employed by Accucaps following the sale.

Generally a break-up fee should be designed to cover the costs of "due diligence" by the initial offeror. In this instance Accucaps is a major supplier of the inventory handled by the debtor-in-possession. It hardly seems reasonable, given Accucaps' knowledge of the debtor and its business, that substantial costs of investigating the viability of a purchase would be necessary.

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Not every cost of inquiry and documentation fall within the scope of those that should be bourne by the estate. The costs of investigating and analyzing a potential purchase and the expense of professionals to document the transaction generally fall on the interested purchaser as a cost of doing business. The break-up fee is a well recognized and potentially useful devise for shifting the cost of inquiry and analysis in appropriate cases, however, a break-up fee should not transform into a stumbling block for other interested purchasers and a shield for the initial offeror.

Finally, issues of post-petition financing and the appropriate bidding procedures for the pre-confirmation sale of assets cannot be decided in a vacuum. The Court is concerned with the direction of what is now apparently a liquidating chapter 11 case. It is important to note that SouthTrust Bank apparently maintains a lien on most of the debtor's assets. SouthTrust has agreed to set aside or carve out One Hundred-Fifty Thousand ($150,000) Dollars from the sale of assets and the repayment of its loan. Notably, the debtor-in-possession projects cost of administration and professional fees leaving only approximately Sixty-six thousand ($66,000) Dollars for application to priority claims that exceed One Hundred thousand ($100,000) Dollars and nothing for the unsecured creditors.

During the course of the hearing on this matter, the Court inquired into the interconnection of the post-petition lending, the break-up fee and the purchase of assets by Accucaps. The representations made were that Accucaps would not go forward with the offer to purchase absent the break-up fee and that the post-petition lending was extended solely in connection with the effort to preserve the going concern value of the debtor-in-possession pending a sale. Because the Court denies approval of the break-up fee, the offer to extend credit is without a condition precedent and must also be denied.

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