IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA

In re:	Chapter 11
ROYAL AUTOMOTIVE COMPANY, et. al,	Case No. 18-20218
	(Jointly Administered)
Debtors.	Judge Frank W. Volk

LIMITED OBJECTION OF THE PENSION BENEFIT GUARANTY CORPORATION TO ROYAL AUTOMOTIVE COMPANY'S MOTION ESTABLISHING SALE PROCEDURES

Pension Benefit Guaranty Corporation ("PBGC"), a creditor with secured claims in excess of $2 million, objects ("Objection") on its own behalf and on behalf of the Royal Automotive Company Employees Retirement Plan (the "Plan") to Royal Automotive Company and Royal Real Estate's (collectively, the "Debtors") *Motion for Orders Authorizing and Approving the Sale of Substantially All Their Assets Pursuant to an Auction and the Assumption and Assignment of Certain Executory Contracts Relating Thereto* [Doc. 3]. PBGC does not oppose the sale of Debtors' assets through a fair and robust process that maximizes value for the Debtors' estates. However, the bidding procedures provide the stalking-horse bidder a break-up fee of $350,000, which, given the purchase price of the assets and the circumstances of this case, will chill bidding and potentially reduce creditor's recoveries. PBGC respectfully requests that the Court limit the amount of break-up fee to $250,000.

BACKGROUND

A. The Pension Plan and PBGC's Guaranty Program

1. PBGC is a wholly owned United States government corporation, and an agency of the United States, which administers the defined-benefit pension-plan insurance program under

Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"), *as amended*, 29 U.S.C. §§ 1301-1462 (2012 & Supp. II 2014). The program guarantees a secure, predictable retirement for more than 40 million American workers.[1]

2. Royal Automotive Company ("Royal Auto") sponsors and administers the Plan, which is a tax-qualified, defined-benefit pension plan covered under Title IV of ERISA. 29 U.S.C. § 1301(a)(13). Royal Real Estate, LLC ("Royal RE") is a member of Royal Auto's controlled group. *See* 29 U.S.C. § 1301(a)(14).[2]

3. When a pension plan covered by Title IV terminates with insufficient assets to pay all promised benefits, PBGC typically takes over the plan, supplements the insufficient assets with its insurance funds, and pays participants their benefits, subject to statutory limits. *See* 29 U.S.C. §§ 1321, 1322, 1361.

4. ERISA contains the exclusive method for terminating a pension plan covered by Title IV. *See Hughes Aircraft v. Jacobson*, 525 U.S. 432, 446-47 (1999) (strict compliance with ERISA is the sole means by which a pension plan covered by Title IV may terminate). If a pension plan has sufficient assets to cover its liabilities, the sponsor can terminate it in a standard termination under 29 U.S.C. § 1341(b). If a plan does not have assets to pay those benefits, PBGC can initiate termination of a pension plan under certain circumstances. 29 U.S.C. § 1342. Additionally, the sponsor can apply for a distress termination under 29 U.S.C. § 1341(b) if it and its controlled-group members meet certain distress tests.

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[1] PBGC 2017 Annual Report at 1, https://www.pbgc.gov/sites/default/files/pbgc-annual-report-2017.pdf.

[2] A "controlled group" is a group of trades or businesses under common control and includes, for example, a parent and its 80% owned subsidiaries. Another example includes a brother-sister group of trades or businesses under common control. *See* 29 U.S.C. §§ 1301(a)(14)(A), (B); 26 U.S.C. §§ 414(b), (c); 26 C.F.R. §§ 1.414(b)-1, 1.414(c)-1, 1.414(c)-2.

5. While a pension plan is ongoing, a sponsor of a plan covered by Title IV and the sponsor's controlled-group members must satisfy certain must satisfy certain financial obligations to the plan. These obligations include (i) paying the statutorily required minimum-funding contributions to the pension plan, 26 U.S.C. §§ 412(b)(1), (2); 29 U.S.C. §§ 1082(b)(1), (2), and (ii) paying insurance premiums to PBGC, 29 U.S.C. §§ 1306, 1307(e)(2).

6. If the sponsor fails to pay one or more required minimum-funding contributions before the due date and the unpaid amount(s), in the aggregate, exceeds $1 million, a statutory lien arises in favor of the pension plan upon all property and rights to property, whether real or personal, belonging to the sponsor and its controlled-group members. 29 U.S.C. § 1083(k); 26 U.S.C. § 430(k). This lien is enforceable by PBGC, 26 U.S.C. § 430(k)(5), and is treated as a tax lien, 26 U.S.C. § 430(k)(4)(c).

7. Additionally, if a plan terminates in a distress or PBGC-initiated termination, the plan sponsor and its controlled-group members are liable to PBGC for the plan's unfunded benefit liabilities—that is, the shortfall of the plan's assets necessary to pay all benefits promised under the plan. 29 U.S.C. §§ 1301(a)(18), 1362. Additionally, the plan sponsor and controlled-group members are liable to PBGC for a termination premium at the rate of $1,250 per plan participant per year for three years. *See* 29 U.S.C. § 1306(a)(7).

8. The liabilities of a plan sponsor and controlled-group members with regard to a pension plan are joint and several. *See* 26 U.S.C. § 412(b)(2); 29 U.S.C. §§ 1082(b)(2), 1307(e)(2), 1362(a).

B. PBGC's Liens

9. PBGC has two secured claims against the Debtors' assets. First, PBGC has liens under 26 U.S.C. § 430(k) against the Debtors for missed minimum-funding contributions in

excess of $1 million. PBGC perfected these liens in filings on March 26, 2013, in the amount of $1,153,204; May 22, 2013, in the amount of $168,196; and November 7, 2013 in the amount of $243,802, with interest continuing to accrue on all amounts.

10. Second, in connection with the sale of Royal Auto's Chrysler and Jeep franchises in 2015, Royal RE granted PBGC a deed of trust on its real property in the amount of $893,493, to secure the Plan's unfunded benefit liabilities as of the date of any distress or PBGC-initiated termination of the Plan. The deed of trust was recorded on October 7, 2015.

11. If the Plan terminates in a PBGC-initiated termination or a distress termination, PBGC also expects to have general unsecured claims for liabilities not fully satisfied by the above liens. PBGC is currently updating its estimate of the Plan's underfunding with the latest available information.

LIMITED OBJECTION

A. The Debtors Have Not Demonstrated the Adequacy of their Marketing Process.

12. The Debtors have a duty to structure the bidding procedures in a way that maximizes value. *See In re Edwards*, 228 B.R. 552, 561 (Bankr. E.D. Pa. 1998) ("The purpose of procedural bidding orders is to facilitate an open and fair public sale designed to maximize value for the estate."). The Debtors are selling their assets on a truncated schedule, with little time to market those assets. However, the Debtors did not explain how they intend to market the assets, saying only that the "prepetition marketing process, together with the additional marketing that will occur up to the bid deadline will, in the Debtors' business judgment, ensure that they procure the highest and best price for the Debtors' assets." Doc. 3 ¶ 43. The Debtors should supplement their motion so that parties can evaluate the reasonableness of the marketing process.

B. The Bidding Procedures and Stalking-Horse Agreement Will Discourage Bidding and Should Not be Approved Without Modification.

13. The asset purchase agreement ("APA") [Doc. 3-1] and Bidding Procedures [Doc. 3-3] include a break-up fee of $350,000, to be paid to Dutch Miller Subaru, Inc. ("Dutch Miller") if it is not selected as the successful bidder. The APA provides for the sale of (i) Royal Auto's Subaru franchise and dealership assets for $3,550,00, plus the value of fixed assets, certain vehicles, and parts and accessories (the "Additional Assets"), and (ii) Royal RE's real property for $2,500,000. The dealership and the real estate are being sold for $6.05 million. A $350,000 break-up fee is equal to 5.8% of the price of these assets. If the Additional Assets generate about $2 million, the break-up fee is equal to about 4.3% of the total price.

14. Break-up fees can be allowed as an administrative expense claim if they reflect the actual and necessary cost of preserving the estate. *In re Tropea*, 352 B.R. 766, 768 (Bankr. N.D.W. Va. 2006). "But merely reciting the theoretical benefits in a motion does not insure that they inure to the benefit of the estate." *In re On-Site Sourcing*, Inc., 412 B.R. 817, 822 n.5 (Bankr. E.D. Va. 2009). Courts must "carefully scrutinize break-up fees to be sure that revenues will be maximized, and absent compelling circumstances that clearly indicate that payment of the fee would be in the best interests of the estate, break-up fees should not be awarded in bankruptcy." *In re Lamb*, No. 96-1-1099-DK, 2002 WL 31508913, at *2 (Bankr. D. Md. Oct. 11, 2002).

15. There has been no showing that the break-up fee is necessary to preserve the value of the estate. The proposed amount, at between 4.3% to 5.8% of the purchase price, is higher than the amount typically approved by courts. *See* 3 Collier on Bankruptcy ¶ 363.02 (16th ed. 2018) (courts have usually limited break-up fees to about 3% of the consideration the buyer will pay for the assets, including assumption of liabilities, absent unusual circumstances).

In fact, courts have refused requests for percentages in Debtors' proposed range. *See, e.g.*, *In re Reliant Energy Channelview LP*, 594 F.3d 200, 203 (3d Cir. 2010) (affirming denial of 3.2% break-up fee due to risk of chilling the bid process); *In re Bidermann Indus. U.S.A., Inc.*, 203 B.R. 547, 553 (Bankr. S.D.N.Y. 1997) (refusing to approve fees in the range of 4.4% to 6%).

16. Moreover, none of the facts pointed out by the Debtors establish unusual circumstances that justify an above-average break-up fee. According to the Debtors, for example, they agreed to pay the break-up fee, "[t]o induce Dutch Miller to act as a stalking horse bidder." Doc. 3 at 4. The benefit to the estate should therefore be the encouragement of "a reluctant prospective bidder to perform its due diligence and make the first bid, thereby opening a vigorous auction." *In re On-Site Sourcing, Inc.*, 412 B.R. at 822 n. 5. But Dutch Miller was not a reluctant bidder. Indeed, Dutch Miller originally entered into a term sheet to purchase the Debtors' assets over a year and a half ago, in August 2016. *See Declaration of Kelly Smith in Support of First-Day Motions*, Doc. 13 ¶ 35. Although the transaction did not close at the time, Dutch Miller "repeatedly extended the term sheet," before the Debtors entered into the APA in April 2018. *Id.* ¶ 37.

17. The Debtors also point out that United Bank supports the break-up fee. Doc. 3 at 16. This, too, does not establish a compelling circumstance. United Bank is assertedly a first priority secured creditor that stands to be paid in full from the proceeds generated by the stalking-horse bid. As such, United Bank will not be affected if the price of the assets increases due to a competitive auction. Instead, PBGC and general unsecured creditors will be affected by the break-up fee.

18. PBGC proposes a break-up fee of $250,000 or 3.1% of the purchase price, assuming that the Additional Assets sell for approximately $2 million. The proposed break-up fee is supported by case law and more adequately represents the value of benefit to the estate.

CONCLUSION

WHEREFORE, PBGC respectfully requests that the Court (i) sustain this Objection; and (ii) grant such other and further relief as the Court may deem just or proper.

Dated: May 15, 2018

Respectfully submitted,

/s/ Adrian Zareba

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