CASE STUDY

KLAUSNER

Two sawmills, one in Florida and one in North Carolina, owned by Austrians who abandoned the mills and employees during early COVID-19, were both in the initial stages of forced liquidation in early March of 2020 as the COVID-19 crisis effectively metastasized around the world. Lawsuits against both Klausner Lumber 1 LLC (KL1, in Florida) and Klausner Lumber 2 LLC (KL2, in North Carolina) had been multiplying on a seemingly daily basis and prior counsel had effectively resigned due to non-payment of mounting bills. Self-help efforts by angry creditors, including the former employees and the counties in which the mills operated, were actively underway. Likewise, angry Chinese EB-5 investors and their phalanx of lawyers were seeking the appointment of receivers with a plan to liquidate the mills. The federal EB-5 program investors brought multiple lawsuits because the properties were returning neither any income nor helping them to earn green cards.

In late March of 2020, through the American law firm of Westerman Ball Ederer Miller Zucker & Sharfstein LLP ("Westerman Ball") and German lawyers representing the Austrian family that owned the mills, Asgaard was asked if it could help stave off liquidation, stabilize the situation generally, and see if the mills could be sold and produce some remnant of enterprise value for the estates and their constituents. As discussed in greater detail below, Asgaard did just that – successfully fighting the receivership actions, getting control of the properties and stopping self-help activities, showing that the installed machinery could still operate, arranging for aerial video tours for foreign buyers who couldn't fly into the US due to worldwide travel restrictions, and coordinating the sale processes that ultimately yielded $150 million in cash proceeds, assumed liabilities, and leases from the sale of the two mills to a new Austrian owner – more than 10 times the estimated $15 million in a forced liquidation scenario.

The path to success was extremely challenging and the results virtually unbelievable, leading to two national awards in 2022. The Turnaround Management Association, for example, named both KL1 and KL2 as the Turnaround/Transaction of the Year for a Small Company, and the Global M&A Network similarly named the KL2 deal the Cross-Border Special Situations Deal of the Year.

Situation Overview

The debtors, comprising KL1 and KL2, were formed to build two state-of-the-art sawmills. They were intended to be the new United States operations of Austria's Klausner family of companies. Utilizing European technology that generated operational efficiencies and far greater utilization of raw materials, these operations would have a competitive advantage over traditional East Coast lumber mills, if successful. Additionally, KL1 and KL2 were strategically located in rural, timber-rich areas with populations that would greatly benefit from new, large employers in the region.

Approximately $147 million was invested in KL1 to render it operational. This initial funding was raised through shareholder and related-party loans and an indirect investment – thought to be as much as $49.5 million – by EB-5 investors in Florida Sawmills, LLC, an affiliate of KL1. Furthermore, key Florida governmental agencies provided several million dollars in direct and indirect grants, support, and infrastructure (building out roads, water, power substations, etc.). Similarly, approximately $166 million was invested in KL2, which included a $75 million construction loan from Carolina Sawmills, a prepetition lender that raised funds through EB-5 investors. This total investment also included $7.8 million in Halifax County support.

After KL1 began production in March of 2015, sales and distribution were not as successful as planned, resulting in mounting trade debt and a continuous drain on liquidity. In addition, by early 2020, KL1's foreign-related parties appeared to be facing financial issues of their own.

Indeed, the liquidity problems at KL1 were acute, and KL1's foreign-related parties – long the source of financial support for KL1's operations – were unable to provide further funding. Additionally, the EB-5 investors in KL1's affiliate lender, Florida Sawmills, were growing restless, asserting that: they had not been provided with adequate information; that they were not obtaining a return on their investments in Florida Sawmills, which was not acting in their interests due to its affiliated status with KL1; and that some of them had not obtained their permanent "green cards," a critical component to providers of EB-5 funds.

Furthermore, in March 2020, KL1's entire management team and numerous operators left the United States over a weekend following the announcement of effective border closures imposed by the German, Austrian, and Swiss governments due to the spread of COVID-19. When KL1's American workers showed up for work on Monday, they were greeted by empty and shuttered plants, with calls to Austria for explanations going unanswered. Having no ability to operate, no financing, and no liquidity, KL1's operations were shuttered immediately. In short, all possible value for creditors and other constituents was on the precipice of being lost.

KL2's financial position was similarly precarious. The company had no money in the bank, no available third-party funding, and no support from its sister company KL1 or its European parent. Halifax County, disappointed by unfulfilled promises, exercised its right of reverter, repossessing the real property upon which the mill sat and leaving KL2 without ownership of its primary asset. By early 2020, receivership was pending, and the mill's equipment and facilities were rapidly deteriorating. The onset of the COVID-19 pandemic exacerbated the situation. The mill's foreign managers and engineers had fled back to Europe just as KL1's personnel had before lockdowns began, leaving the plant without crucial on-site knowledge and operational oversight. The lack of financial or operational data further hindered any efforts to salvage the mill. Worst of all, both mills were burdened by numerous lawsuits, particularly from the EB-5 investors who now didn't have income from the mills and were at risk of losing a path to green cards as well.

Asgaard and the Professionals Get Hired and Go to Work

In March 2020, Asgaard Capital, completely unfamiliar with the sawmills, was contacted by Westerman Ball, which had been contacted by the Austrian owners. Asgaard realized that if the sawmills remained shuttered and inactive, there would be a significant risk to creditor recoveries. There was no money available, and professionals would have to work at risk for some time before sales would be possible.

In order to improve the chances of the professionals in both estates being hired, a consent and subordination agreement was negotiated by Asgaard. It gave the professionals of KL1 and KL2 cases a senior position to the companies' senior lenders for their fees. The senior lenders also agreed to subordinate their claims to any bankruptcy financing (DIP) lenders. Further protections were offered to administrative claims, unsecured creditors, and if needed, a Chapter 7 trustee. Despite these protections, the professionals' fees were at risk if the sawmill auctions were not successful, due to the debts and judgments outstanding.

Asgaard's and the other professionals' efforts in the two cases focused initially on improving KL1, the debtor in Florida. This was because the receivership self-help actions were further advanced (particularly by the county, which had hired a firm to seize – in the debtor's view, illegally without a warrant – the debtor's equipment to pay past due property (ad valorem) taxes. Asgaard and Westerman Ball halted state court receiverships and liquidation efforts, and ultimately moved the cases to bankruptcy court in doing so.

Meanwhile sister-entity KL2, the debtor in North Carolina, had been partially completed but was not operational.

Because prior counsel was no longer working due to significant overdue legal bills, both Asgaard and new lawyers had to be retained for both estates, and independent directors (and counsel for them) recruited because of the Klausners' claims as both creditors and equity holders. Here, one major difficulty was that all professionals had to work initially at risk because the Austrian family could not fund any retainers, and none of the traditional DIP lenders were interested in providing a DIP due to the size and uncertain value of the collateral. Notwithstanding large law firms' reluctance to work on spec (and particularly restructuring counsel), Asgaard, based on its longstanding relationships with senior attorneys at most of the firms and prior results achieved by counsel in similarly distressed situations, was able to convince all the required counsel (and the debtor's investment banker) to work at risk.

With the professionals on board, both companies knew they had to quickly prepare for chapter 11 filings, in large part to get the benefit of the automatic stay and have the state receivership cases moved to federal district courts and ultimately to the Bankruptcy Judge assigned the cases in Delaware. KL1 filed for bankruptcy on April 30, 2020, and subsequently KL2 filed on June 10, 2020.

Raising Finances

Despite the initial lack of interest from DIP lenders, Asgaard identified lenders willing to provide critical DIP financing for KL1 and KL2 so that both companies could pay expenses required to be paid in chapter 11, including insurance, security, power to the sites, as well as funds to perform required maintenance necessary to keep the equipment from becoming inoperable when the plants re-opened. These efforts ultimately resulted in an initial DIP with Big Shoulders, to provide $2.0 million in junior DIP financing for KL1 shortly after the filing for bankruptcy. For KL2, a $2.5 million DIP from Legalist grew to $5.5 million after the stalking horse bid for KL2's assets was obtained. The creative DIPs gave both estates the liquidity to reach extraordinarily successful 363 sales results.

Operational Restructuring Efforts

Asgaard led the operational turnaround of KL1, while simultaneously maintaining the nonoperational KL2 facility. These strategic actions and the partnerships formed during this process were crucial in revitalizing the sawmills.

Asgaard provided a Chief Restructuring Officer (CRO) for KL1, who relocated to the KL1 site and created conditions for showing the mill at its best to potential buyers. This included restoring local networks, rehiring key former employees, and developing strong partnerships with local authorities.

Because the county had reassumed ownership of KL2's real property, a sale of assets on site was the only option to raise cash in the short term. Asgaard similarly provided a CRO for KL2, who managed to sell two pieces of mobile equipment and some miscellaneous assets to fund minimal operations. Since the county owned the real property, Asgaard negotiated with them to pay for insurance, security, and utilities at the plant.

The KL1 and KL2 Sale Processes

The sale process for KL1 was marked by innovative strategies that were required because the estate faced unusually high hurdles. When Asgaard was engaged, all financial records were on the Austrian parent's servers to which no one in America had access, and there were no employees – including financial staff – to help re-create the financial information most buyers would seek. To solve this problem, Asgaard obtained some older historical information for KL1 that had been prepared by Deloitte as part of a prior failed sale process in Europe that preceded the bankruptcy, and through negotiations gained some limited access to financial information on the Austrian servers.

This lack of records also posed issues in providing buyers with a list of assets to be transferred in the 363 sale (as there were no current records detailing what exactly KL1 owned). Further, the foreign buyers who had shown the most interest in acquiring the sawmill could not fly into the country to inspect the plant or equipment. Nonetheless, the Asgaard KL1 CRO created conditions to solve both of these problems by employing drone videography that provided a complete virtual tour of the facility, including segments that demonstrated that the equipment was indeed still operational. The video was also used to demonstrate what equipment and supplies would be conveyed (i.e., everything the buyers could see on the videos).

The KL1 mill was sold for approximately $63 million in August 2020. A competitive auction for KL1 saw significant interest from international bidders. binderholz, a firm familiar with the high-tech sawmill line used in its other plants in Europe, emerged as the new owner of KL1.

The KL2 sales process faced its own unique problems, in addition to the complete lack of financial information. Because Halifax County owned the real property, a sale of the entire plant was initially impossible. Asgaard was able to negotiate a deal with the county where the county would sell the real property to the estate of KL2, enabling KL2 to sell the whole plant in a 363 auction. KL2 also used drone videography for its potential buyers.

Additionally, the EB-5 investors were furious, and their lawyers were particularly litigious in the KL2 case. This federal EB-5 program was used by investors in both KL1 ($49.5 million) and KL2 ($75 million). Under this program, a foreign national (Chinese in these two cases) would pay $500,000 into projects that created U.S. jobs in the expectation of getting green cards. Due to the lack of progress on the two sawmills and on the lack of information, both groups of the EB-5 sawmill investors were angry, litigious and complicated the sale process with numerous demands and objections.

$63 MILLION
KL1 selling price

$87 MILLION
KL2 selling price

Specialty EB-5 counsel to the estates structured a transaction in KL2 that provided the foreign EB-5 investors, most of whom invested in KL2, a continuing opportunity to obtain green cards by keeping their investment at risk, as required. This cleared the way for the sale, and the competitive auction for KL2 saw binderholz emerge as the new owner of KL2 as well.

KL2, despite having never been completed nor operational, was sold for approximately $87 million in January 2021.

Results and Recoveries

The financial outcomes of the KL1 and KL2 sales were notable and provided substantial recoveries for creditors and other stakeholders. The strategic actions taken by Asgaard and its partners ensured that the mills were sold for amounts far exceeding what they would have generated in liquidation.

The sale of KL1's assets resulted in over $30 million in recoveries for creditors. This included $19 million to Florida Sawmills (i.e., the EB-5 investors), $3.7 million to Klausner affiliates, and $7.2 million to trade creditors. Secured claims held by Florida Sawmills and other affiliates received 100% recovery under the plan, while holders of general unsecured claims were expected to receive a 95% return on account of their claims. The sale also ensured that past due taxes were paid, and the mill's operations were revitalized, contributing to the local economy and providing employment opportunities. The sale of KL2 also resulted in significant recoveries to various classes of claims. Secured claims received a 100% recovery, while unsecured claims saw varying recoveries based on the outcome of adversary proceedings. Most importantly, claims held by Carolina Sawmills (i.e., the EB-5 investors) received an estimated 100% recovery, in the form of either cash equal to their allowed secured claim or the property that served as security for such claim.

Asgaard was able to achieve something truly special in these cases. Fundamentally, it was essential for Asgaard to construct the right team of complementary lawyers (local bankruptcy counsel, conflicts counsel, committee counsel, specialty immigration counsel, and local litigation counsel) and an investment banker to market and sell two closed mills with no operations or employees, with a foreign owner, and with foreign investors. Furthermore, these professionals had to agree to work at risk (i.e., no material payments were made in either case until the applicable sale was completed). This meant that, in order to get the estate's stakeholders – and, likewise, the bankruptcy professionals – recoveries, the debtors had to win virtually every motion in the cases – which they did, going 10-0 in KL1 and 19-0 in KL2. This could not be done without the talented team of professionals working together.

The successful turnaround and sale of the KL1 and KL2 mills had a profound impact on the local communities in Suwannee County, FL, and Halifax County, NC. The counties regained significant tax contributions, with the KL1 mill contributing $2.1 million in combined county and school board taxes, representing approximately 10% of rural Suwannee County's total budget of $20 million. Halifax County, similarly, received $4.6 million in cash from its original contribution to KL2, plus an agreement to receive an additional approximate amount of $3.3 million if employment levels were not met within a specified timeframe. The county also received $1.2 million in back taxes. More importantly, however, the revitalized sawmills provided much-needed employment opportunities to the local communities, and utilities, lumber companies, tree farmers, and other businesses related to the mills gained a steady and ongoing customer. The successful turnaround of the mills ensured that these related industries continued to thrive, contributing to the overall economic health of the regions.

These results, unsurprisingly, led these engagements to be recognized in 2022 as two of the most successful transactions of the year. In addition to the awards, it is important to note that all of the professionals were paid 100% of their hourlies and transaction fees.