

1 Ali M.M. Mojdehi, State Bar No. 123846
Christine E. Baur, State Bar No. 207811
2 Janet D. Gertz, State Bar No. 231172
BAKER & McKENZIE LLP
3 101 West Broadway, Twelfth Floor
San Diego, CA 92101-3890
4 Telephone: +1 619 236 1441
Facsimile: +1 619 236 0429

5 Counsel for the Allegiant Investors
6
7

8 UNITED STATES BANKRUPTCY COURT
9 SOUTHERN DISTRICT OF CALIFORNIA

10 In re

11 SERACARE LIFE SCIENCES, INC.,
12 a California Corporation (d/b/a Therasource
International; f/k/a The Western States Group,
13 Inc.; d/b/a Biomedical Resources, a division of
SeraCare Life Sciences, Inc.; d/b/a Genomics
14 Collaborative, a division of SeraCare Life
Sciences, Inc.; f/k/a Southwest Biological
15 Services Western States Plasma Co., Inc.; d/b/a
Boston Biomedica, Inc.; d/b/a SeraCare
16 Bioservices; and d/b/a SeraCare Diagnostics),

17 Debtor and Debtor-in-
18 Possession.

Case No. SD 06-00510 LA11

Chapter 11

**ALLEGIAN'T INVESTORS' REPLY
TO OBJECTION OF AD HOC
EQUITY COMMITTEE TO
DEBTOR'S MOTION FOR ORDER (1)
APPROVING BREAKUP FEE, (2)
AUTHORIZING PAYMENT OF
LEGAL FEES AND DUE DILIGENCE
EXPENSES, AND (3) SETTING
HEARING ON MOTION FOR
APPROVAL OF SECURED
FINANCING PURSUANT TO
SECTION 364**

Date: August 31, 2006

Time: 3:00 p.m.

Dept: 2

Judge: Hon. Louise DeCarl Adler

19
20
21
22
23 Robeco Investment Management, Cohanzick Management LLC; Fairfield Greenwich Group;
24 Foxhill Capital Partners LLC; Gruber & McBaine Capital Management; Seven Bridges
25 Management, L.P.; and Triage Capital Management LP (collectively, the "Allegiant Investors" or
26 "Allegiant"), hereby submit this Reply to the Objection (the "Objection") of the Ad Hoc Equity
27 Committee ("AHEC") to debtor Seracare Life Sciences, Inc.'s (the "Debtor") Motion for an Order:
28 (1) Approving a Breakup Fee; (2) Authorizing Payment of Legal Fees and Due Diligence Expenses;

TABLE OF CONTENTS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

	<u>Page</u>
I. INTRODUCTION	2
II. FACTS	3
III. THE AD HOC EQUITY COMMITTEE SEEKS TO FRUSTRATE THE RESULTS OF THE BIDDING PROCESS	5
IV. THE ALLEGIANT INVESTORS HAVE ACTED IN GOOD FAITH	7
V. THE BREAK-UP FEE SHOULD BE APPROVED	8
A. The Break-Up Fee is Fair and in Good Faith Where Conditioned on Adherence to the Terms of the Letter of Intent.....	9
B. The Break-Up Fee is Reasonable.....	9
C. The Break-Up Fee is a Proper Exercise of the Debtor’s Business Judgment Where It Encourages Open Bidding	10
D. The Break-Up Fee Is In the Best Interest of the Estate, Creditors, and Equity Holders Alike	10
E. The Break-Up Fee Provides Both Quantitative and Qualitative Benefits to the Debtor	12
F. The Break-Up Fee is Part of a Financing Arrangement Specifically Approved by the Bankruptcy Code.....	13
VI. THE ALLEGIANT INVESTORS’ LEGAL FEES AND DUE DILIGENCE EXPENSES BENEFIT THE ESTATE AND SHOULD BE APPROVED.....	15
VII. CONCLUSION.....	15

TABLE OF AUTHORITIES

Page

FEDERAL CASES

1

2

3

4 *In re 995 Fifth Avenue Associates, L.P.*,
96 B.R. 24 (Bankr. S.D.N.Y. 1989).....8

5

6 *In re America West Airlines, Inc.*,
166 B.R. 908 (Bankr. D. Ariz. 1994).....10, 11

7

8 *In re Exide Technologies*,
340 B.R. 222 (Bankr. D. Del. 2006).....13

9

10 *In re Integrated Resources, Inc.*,
135 B.R. 746 (Bankr. S.D.N.Y. 1992), *aff'd*, 147 B.R. 650 (S.D.N.Y. 1992), *appeal dis.*,
3 F.3d 49 (2d Cir. 1993).....8

11

12 *In re Continental Airlines, Inc.*,
780 F.2d 1223 (5th Cir. 1986)14

13

14 *In re Defender Drug Stores, Inc.*,
145 B.R. 312 (9th Cir. BAP 1992).....14

15

16 *In re Integrated Resources, Inc.*,
135 B.R. 746 (Bankr. S.D.N.Y. 1992), *appeal dis.*, 3 F.3d 49 (2d Cir. 1993)8, 10

17

18 *Janas v. McCracken (In re Silicon Graphics Sec. Litig.)*,
183 F.3d 970 (9th Cir. 1999)10

19

20 *In re Mid-State Raceway, Inc.*,
323 B.R. 40 (Bankr. N.D.N.Y. 2005)14

21

22 *Motorola, Inc. v. Official Committee of Unsecured Creditors (In re Iridium Operating LLC,*
et al.),
2005 U.S. Dist. LEXIS 5483 (S.D.N.Y. 2005).....14

23

24 *Munford v. Valuation Research Corp. (In re Munford, Inc.)*,
98 F.3d 604 (11th Cir. 1996)10

25

26 *In re O'Brien Environmental Energy, Inc.*,
181 F.3d 527 (3d. Cir. 1999).....8, 12

27

28

TABLE OF AUTHORITIES
(continued)

		<u>Page</u>
1		
2		
3		
4	<i>In re Quanalyze Oil & Gas Corp.,</i> 250 B.R. 83 (Bankr. W.D. Tx 2000).....	6
5		
6	<i>In re S.N.A. Nut Co.,</i> 186 B.R. 98 (Bankr. N.D. Ill. 1995)	8
7		
8	<i>In re Tama Beef Packing, Inc.,</i> 290 B.R. 90 (8th Cir. BAP 2003)	15

FEDERAL STATUTES

9		
10		
11	11 U.S.C. § 363(b)	6, 8, 12, 13, 15
12	11 U.S.C. § 364.....	2, 14

OTHER

13		
14		
15	Mark F. Hebbeln, <u>The Economic Case for Judicial Deference to Break-Up Fee Agreements</u> <u>in Bankruptcy</u> , 13 Bankr. Dev. J. 475 (1997).....	8
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		
26		
27		
28		

1 and (3) Setting a Hearing on the Debtor’s Motion for Approval of Secured Financing Pursuant to
2 Section 364 (the “Motion”).

3 I. INTRODUCTION

4 For months, the AHEC has had an opportunity to play a constructive role in this case.
5 Instead, and despite its attempts to posture as a “white knight,” the AHEC proposed financing that
6 would have allowed it to acquire control of the Debtor at the cheapest possible price, all at the
7 expense and to the great detriment of the same equity holders it now pretends to protect. It then
8 spurned a counterproposal from the Debtor containing terms slightly more favorable to the rest of
9 the equity holders. This is when an allegiant group of investors emerged, bringing fairness and
10 openness to a previously chilled and one-sided bidding process.¹

11 In contrast to the AHEC, the Allegiant Investors made financing proposals more reflective of
12 the underlying value of the estate, sought through its proposals to enhance the welfare of all
13 constituents (including the equity holders), and worked constructively with the Debtor. Mindful of
14 the Debtor's obligations, the Allegiant Investors even insisted that, before accepting its proposal, the
15 Debtor must provide the other bidders an opportunity to make their best offer by a date certain.
16 Despite the invitation, no party made an offer that was superior, and the Debtor chose to accept the
17 offer presented by the Allegiant Investors.

18 Perhaps alarmed that the Allegiant Investors had unmasked its agenda, the AHEC began
19 making false allegations, accelerated litigation tactics, and has now filed an objection to the
20 Allegiant Investors’ proposal, a proposal that, by being vastly superior to the AHEC’s original
21 proposal, has already added tremendous value to the estate. The AHEC Objection is nothing short
22 of an attempt to frustrate the results of the bidding process—a process in which the AHEC have been
23 intimately involved from the outset and yet have nonetheless failed to produce a satisfactory bid.

24 The central thrust of the AHEC Objection is to the break-up fee, but any force to this
25 objection has been thoroughly negated: The adjusted break-up fee is at a level even AHEC concedes
26 is reasonable. Indeed, it is beyond dispute that the terms of the Allegiant Investors’ offer, as

27 ¹ We chose the “Allegiant Investors” representative name after learning of the prior dealings and
28 proposals by the parties in this case and the corresponding need for the involvement of a supportive,
constructive, and loyal player.

1 adjusted, are reasonable, fair, and beneficial to the estate. Furthermore, the Allegiant Investors have
2 submitted a quantitatively superior bid. In addition to the quantitative values the Allegiant Investors
3 have already added, however, the Allegiant Investors' continued participation in the bid process
4 would be further accretive to enhancing the Company's welfare and benefiting all constituents, thus
5 providing qualitative benefits that merit not only the Allegiant Investors' selection as the stalking
6 horse bidder, but also provide additional support for the Court's approval of the break-up fee
7 contained in the Allegiant Investors' financing proposal.

8 II. FACTS

9 As set forth in the Motion, on August 16, 2006, the Debtor and the Allegiant Investors
10 entered into a letter of intent and term sheet (collectively, the "LOI") whereby the Allegiant
11 Investors would provide post-petition financing to the Debtor. Long before the Allegiant Investors'
12 emergence, the AHEC had attempted to arrange potential financing terms with the Debtor. *See*
13 *Objection* at 7:13-14. Pursuant to a term sheet dated May 25, 2006, the AHEC submitted an offer
14 proposing \$15 million in financing at 9% interest per annum, payable monthly in arrears (the
15 "AHEC Offer"). *See Declaration of Brian L. Cohen ("Cohen Decl.")*, filed concurrently herewith
16 ¶ 3. The AHEC Offer proposed financing on a secured basis and was convertible into a minimum of
17 26.3% of the common shares of any reorganized Debtor on a fully diluted basis. *Id.* Moreover, the
18 resulting capital structure under the AHEC proposal would have allowed the AHEC to exercise a
19 cumulative majority ownership control of the Debtor without payment of a control premium. In fact,
20 the AHEC offer would have resulted in massive dilution.

21 In response to the AHEC Offer, and in an attempt to salvage its fate, the Debtor submitted its
22 own term sheet, dated June 16, 2006, proposing instead \$10 million in financing at 8% interest per
23 annum payable in arrears (the "Counterproposal"). *Cohen Decl.* ¶ 8. The Counterproposal was on a
24 secured basis convertible at \$4.00 per share. *Cohen Decl.* ¶ 8.

25 In the meantime, the Allegiant Investors engaged in a thorough and comprehensive analysis
26 of the Debtor's estate. Based on its assessment of the true underlying value of the estate, the
27 Allegiant Investors began negotiating a financing arrangement with the Debtor. The Allegiant
28 Investors were mindful, however, of the Debtor's obligations while in bankruptcy and insisted that,

1 prior to accepting any term sheet from the Allegiant Investors, the Debtor must afford other
2 interested parties an opportunity to make offers by a date certain. Cohen Decl. ¶ 9.

3 A formal bid deadline was put in place and communicated to interested bidders: “After
4 several weeks of negotiations, . . . the Debtor requested the most serious potential bidders to submit
5 their best written offer by 9:00 a.m. Pacific Time on Monday, August 14, 2006.” Declaration of
6 Paul J. Couchot in support of the Motion ¶ 3.

7 It is the Allegiant Investors’ understanding that both the AHEC and Gateway Capital
8 Management LLC (“Gateway”) were requested to submit offers. Cohen Decl. ¶ 9. After the
9 expiration of the bidding period, the Debtor deemed the Allegiant Investors’ offer to be the superior
10 offer, and the LOI was executed.

11 The Allegiant Investors’ offer is far superior, not only to the AHEC Offer, but to the
12 Counterproposal submitted by the Debtor as well. Cohen Decl. ¶ 5. For instance, from a pure share
13 dilution standpoint, the Allegiant offer results in the acquisition of 16.7% of shares outstanding (on a
14 fully diluted basis), as opposed to 21.7% pursuant to the Counterproposal and (at least) 26.3%
15 pursuant to the AHEC Offer. In addition, Allegiant proposes a conversion price at a premium, \$5.50
16 per share, as opposed to both the \$4.00 per share price requested in the Counterproposal and the
17 massively diluted proposal by the AHEC.

18 In an effort to absorb the risk associated with proceeding with the due diligence necessary to
19 proceed under its offer, the LOI contemplates the payment of a break-up fee, payable in the event the
20 Debtor accepts an offer superior to Allegiant’s (itself creating value for the Debtor). Allegiant’s
21 entitlement to the break-up fee, however, is conditioned on Allegiant funding the financing pursuant
22 to the terms of the LOI. Cohen Decl. ¶ 10. The only instance in which Allegiant would be entitled
23 to the fee prior to funding is if Allegiant was willing to proceed according to the LOI and the Debtor
24 does not proceed. Cohen Decl. ¶ 10. Further, if the material terms of the LOI were to change to the
25 detriment of the Debtor, Allegiant would not be entitled to payment of the fee. Cohen Decl. ¶ 10.

26 Since entering into the LOI, the Allegiant Investors have voluntarily made adjustments to the
27 terms of their offer. Cohen Decl. ¶ 2. Allegiant has decreased the requested break-up fee by 40%, to
28 \$750,000, and has agreed to extend credit on an unsecured basis with administrative priority. Cohen

1 Decl. ¶ 2. These adjustments result in an even greater benefit to the Debtor, the creditors, and the
2 equity holders. Cohen Decl. ¶ 2. We understand the Allegiant Investors' offer has the support of the
3 Official Committee of Unsecured Creditors, a party intimately involved in this case. *See* Statement
4 of Position of Official Committee of Unsecured Creditors to Motion (Docket No. 582).

5 **III. THE AD HOC EQUITY COMMITTEE SEEKS TO FRUSTRATE THE RESULTS OF**
6 **THE BIDDING PROCESS**

7 The AHEC seizes this opportunity to object to the terms of Allegiant's offer, and attempts to
8 overstep the results of the bidding process initiated by the Debtor and to find a pretext to now submit
9 a belated offer, substantially similar to the accepted Allegiant offer. Allegiant's offer was submitted
10 timely under the bid procedures set forth by the Debtor and pursuant to the Debtor's invitation to do
11 so. Allegiant's offer was selected as the most favorable offer because, for many reasons, the
12 Allegiant offer is far superior to the initial AHEC Offer.

13 The AHEC now seeks to cast aspersions on the terms of Allegiant's offer, even though the
14 AHEC initially made a *significantly* less favorable offer. The Objection does not, and cannot,
15 however, deny that the Allegiant proposal is more favorable to the equity holders than the AHEC
16 Offer. Although the AHEC now attempts to offer financing on substantially similar terms to the
17 Allegiant proposal, the AHEC's new offer is untimely and otherwise constitutes a blatant disregard
18 for the bidding procedures set forth by the Debtor.²

19 The overall terms of the accepted offer, however, are not directly at issue at this juncture.
20 Instead, the Debtor has only requested Court approval of the break-up fee and the proposed
21 reimbursement of certain expenses at this time. When the appropriate time comes, the material
22 terms of Allegiant's offer can be challenged by the AHEC or any other interested party at the
23 hearing requested by the Debtor for approval of the financing. In fact, pursuant to the Court's
24 termination of exclusivity on August 24, 2006, the AHEC is free to submit for confirmation its own
25 plan of reorganization with a proposed financing arrangement. In order to advance the Debtor's

26 _____
27 ² The analysis regarding untimely bids/offers is equally applicable to any "stalking horse" offer
28 submitted by Gateway pursuant to its Notice of Intent to submit such an offer filed with this Court
on August 23, 2006, Docket No. 563. Similar to the AHEC, we understand that Gateway has been
involved in this case for some time and was given the same opportunities to submit a "stalking
horse" offer during the bidding period set by the Debtor.

1 goals of repaying certain creditors pursuant to its previous promises, however, the narrow issue of
2 the Court’s approval of the break-up fee and other expenses of the Allegiant Investors are properly at
3 issue now.

4 Furthermore, AHEC’s tactics are offensive to an orderly sale process. Where, as in this case,
5 the prospective bidders have not “played by the rules,” adhering to prescribed bid procedures, courts
6 have not hesitated to preclude such persons’ continued participation in the sale process. For
7 example, in judicially-sanctioned sales under Bankruptcy Code section 363, the courts have found
8 that “[a] lack of finality in sale procedures will lead ineluctably to fewer successful sales and greater
9 difficulty in attracting real buyers.” *In re Quanalyze Oil & Gas Corp.*, 250 B.R. 83, 92 (Bankr.
10 W.D. Tx 2000). Thus, public policy militates against allowing later bidding, even if the offers are
11 more attractive, after the expiration of promulgated bidding periods. *Id.*

12 Likewise, an open-ended and uncertain bidding period places more risk on the bidding
13 parties, providing even further support for a break-up fee. In this particular case, allowing offers by
14 the AHEC and Gateway after these same parties failed to submit a proposal before the expiration of
15 the Debtor’s specified bidding period also fails to advance the Debtor’s stated goal of reorganizing
16 as soon as possible. *See* Motion at 10:24-25. If these parties were allowed to submit “stalking
17 horse” offers on an ongoing basis, the dealings between various parties could last months, and would
18 delay the promised payments to the Debtor’s secured lenders and other constituents. Thus, the
19 AHEC’s untimely offer in an attempt to match Allegiant’s offer (less a break-up fee), as well as any
20 further offer by Gateway are contrary to public policy, contrary to relevant precedent, and would
21 ultimately hinder the Debtor’s reorganization efforts if given consideration.

22 The AHEC itself has on numerous occasions additionally opined that the Debtor should
23 adopt a “rights offering” financing arrangement instead of the financing arrangement proposed by
24 Allegiant. *See, e.g.*, Objection ¶ 6. The AHEC, however, failed to submit any such offer to the
25 Debtor within the bidding period. In fact, as the Debtor stated to the Court at the August 24, 2006
26 hearing, the Debtor still has received nothing more than the AHEC’s vague allusions to such an
27 arrangement. In any event, such a proposal would now be untimely and the AHEC’s seeming
28 intention to continue courting the Debtor with similar alternative arrangements provides even further

1 support for approving the break-up fee.

2 **IV. THE ALLEGIANT INVESTORS HAVE ACTED IN GOOD FAITH**

3 The Allegiant Investors have consistently displayed good faith in their dealings with the
4 Debtor. The Allegiant Investors specifically conditioned the Debtor's acceptance of any term sheet
5 on providing all interested parties the opportunity to submit competing offers of financing on or
6 before a date certain. Thus, the AHEC and other interested parties were invited and given fair
7 chance to submit their *best* written offers. It was only after this specific bidding period terminated
8 that the Debtor assessed the bids and accepted the Allegiant offer.

9 The AHEC, on the other hand, has displayed a willingness to sacrifice the interests of the
10 Debtor and the other shareholders to advance its own economic interests. In addition, it has
11 repeatedly made misrepresentations to further its own interests. For instance, the AHEC has alleged
12 that Allegiant and the Debtor agreed to provide releases to certain directors in conjunction with
13 acceptance of the Allegiant offer. At no time was the subject of releases ever discussed by the
14 parties. *See* Cohen Decl. ¶ 10; Declaration of Robert Cresci in Response to Reply of AHEC Re
15 Motion to Lift Stay and, Alternatively, to Terminate Exclusivity, attached hereto as Exhibit "A"
16 ("Cresci Decl.") at ¶ 6. In fact, when challenged by this Court at the August 24, 2006 hearing,
17 counsel for the AHEC failed to identify any evidence that such discussion or negotiation had taken
18 place.

19 The Allegiant Investors' offer additionally demonstrates that it is not just an opportunistic
20 bidder. If Allegiant were simply interested in submitting the lowest possible bid the market could
21 bear, it would have merely matched the terms of the Counterproposal. Instead, Allegiant submitted a
22 financing offer based on its assessment of the true underlying value of the estate, not merely in
23 response to AHEC's bid or to the Counterproposal. In fact, it is telling that Allegiant proposes to
24 convert at a premium of \$5.50 per share, while the AHEC sought to exercise its conversion rights at
25 a much lower per share value and additionally gain control *without paying a control premium*. The
26 AHEC's efforts to push financing based *not* on its valuation of the Company, but on what it could
27 try to get away with, typifies its rapacious, self-serving approach to this bankruptcy estate.

1 **V. THE BREAK-UP FEE SHOULD BE APPROVED**

2 A break-up fee is a fee paid to a potential purchaser or lender in the event the contemplated
3 transaction is not consummated. *In re Integrated Resources, Inc.*, 135 B.R. 746, 750 (Bankr.
4 S.D.N.Y. 1992), *aff'd*, 147 B.R. 650 (S.D.N.Y. 1992), *app. dismissed*, 3 Fed.3d 49 (2d Cir. 1992).
5 The break-up fee is widely recognized in both the bankruptcy and non-bankruptcy contexts and is
6 commonly seen where a judicial sale is authorized and subject to overbid. *See* 11 U.S.C. § 363(b).
7 The rationale behind break-up fees is that the potential purchaser or lender incurs certain risks and
8 invests considerable resources in completing its due diligence investigation of the target asset or
9 borrower. *In re 995 Fifth Avenue Associates, L.P.*, 96 B.R. 24, 29, & n.6 (Bankr. S.D.N.Y. 1989).

10 As stated in the Motion, there appears to be no controlling Ninth Circuit authority
11 establishing a standard for court scrutiny and approval of break-up fees. The courts of other circuits
12 have adopted varying approaches. *Compare In re Integrated Resources, Inc.*, 147 B.R. 650
13 (S.D.N.Y. 1992), *app. dismissed*, 3 F.3d 49 (2d Cir. 1993) (adopting the “business judgment” rule);
14 *with In re S.N.A. Nut Co.*, 186 B.R. 98 (Bankr. N.D. Ill. 1995) (analyzing whether break-up fee will
15 further interests of debtor, creditors and equity holders); *and with In re O’Brien Environmental*
16 *Energy, Inc.*, 181 F.3d 527 (3d. Cir. 1999) (analyzing break-up fee under Bankruptcy Code section
17 503(b) standard). Although the break-up fee proposed in this instance should be approved under any
18 of these tests, the analysis under the business judgment rule propounded in *In re Integrated*
19 *Resources* provides a level of scrutiny sufficient to protect the interests of all parties. *See generally*,
20 Mark F. Hebbeln, The Economic Case for Judicial Deference to Break-Up Fee Agreements in
21 Bankruptcy, 13 Bankr. Dev. J. 475 (1997).

22 The courts that have determined the propriety of break-up fees under the business judgment
23 test, while giving deference to the Debtor’s decision, have examined the potential for the break-up
24 fee to chill or, alternatively, to enhance the bidding process. *In re Integrated Resources*, 147 B.R. at
25 650. In this case, as explained below, the relationship of the parties is arms’ length, in good faith,
26 the amount of the fee is reasonable, and the break-up fee will encourage and assist fair and open
27 bidding.

1 **A. The Break-Up Fee is Fair and in Good Faith Where Conditioned on Adherence to the**
2 **Terms of the Letter of Intent**

3 In this case, as proven by the Allegiant Investors' fair offer and ethical prior conduct towards
4 the Debtor, the relationship of the parties to each other, as well as to the break-up fee, is in good
5 faith and at arms' length. The AHEC's untoward focus on the conditional nature of the LOI is
6 misplaced and misleading. The break-up fee is expressly conditioned on Allegiant committing to
7 fund the Debtor. The only circumstance where Allegiant would be entitled to the break-up fee
8 absent funding is where the Debtor does not proceed with the financing despite Allegiant's desire to
9 fund. In all other instances, Allegiant's entitlement to the fee is premised on funding.

10 In addition, the AHEC's assertion that Allegiant would have the ability to alter or negotiate
11 the terms of the financing after approval of the break-up fee is erroneous. First, the Allegiant
12 Investors have always acted in good faith in its dealings with the Debtor and, as proven by their past
13 conduct in respect to the Debtor, would not conduct themselves in such an unfair manner. More
14 importantly, the terms of the LOI preclude any such result. The break-up fee is premised on the
15 parties' performance of the material terms of the LOI. If the material terms of the LOI are changed
16 to the detriment of the Debtor, Allegiant would not be entitled to the break-up fee. Thus, the express
17 provisions of the LOI are self-executing in promoting fairness.³

18 **B. The Break-Up Fee is Reasonable**

19 The proposed break-up fee is reasonable in relation to the proposed financing and the risk
20 incurred in undertaking such an arrangement. Allegiant has unilaterally and voluntarily reduced the
21 break-up fee by 40% to \$750,000. The reduced break-up fee represents a mere 3% of the proposed
22 \$25 million financing amount. As conceded by the AHEC, courts have found that "break-up fees
23 that are less than approximately 3.5% are typical." Objection at 16:4-5. Accordingly, where the
24 break-up fee proposed by the Debtor is less than the typical fee amount approved by the courts, it is
25

26 ³ Perhaps conceding the inherent good faith and fairness of the Allegiant offer, the AHEC makes
27 several unsupported assertions that the Debtor's acceptance of Allegiant's offer is "tainted by
28 ulterior motives" of the Debtor's directors due to their concerns over pending litigation. The
Objection fails to state, much less set forth any evidence, connecting that litigation to the directors'
approval of the break-up fee at issue here. Moreover, the subject of releases from liability was never
discussed by the parties. Cohen Decl. ¶ 10; Cresci Decl. ¶ 6.

1 inherently reasonable.

2 **C. The Break-Up Fee is a Proper Exercise of the Debtor’s Business Judgment Where It**
3 **Encourages Open Bidding**

4 Under the business judgment rule, courts give substantial deference to the decisions of a
5 debtor’s board of directors when such decisions are made in a deliberate and informed manner. *See*
6 *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604, 611 (11th Cir. 1996).
7 Pursuant to the rule, absent evidence of self-dealing, fraud, or bad faith, “directors are presumed to
8 make sound business decisions, and to inform themselves properly prior to making those decisions.”
9 *Janas v. McCracken (In re Silicon Graphics Sec. Litig.)*, 183 F.3d 970, 990 (9th Cir. 1999). The
10 dominant issue considered by a court in determining the propriety of a break-up fee under the
11 business judgment standard is whether the offer of the party to whom the payment is to be made will
12 enhance the bidding process. *In re Integrated Resources, Inc.*, 135 B.R. at 751.

13 The AHEC contends that the break-up fee will either chill additional, perhaps more superior,
14 offers of financing from other interested parties. The AHEC contentions are pure conjecture, as the
15 AHEC has failed to set forth any evidence that any interested party would be unwilling to make a
16 superior offer if the break-up fee is approved. In fact, subsequent to the time Allegiant entered into
17 the LOI, the AHEC and Gateway have repeatedly expressed their intent to submit financing offers.
18 Although offers from these parties would be untimely, their conduct evidences that the Allegiant
19 offer has actually encouraged, rather than chilled, bidding.

20 Moreover, the payment of the break-up fee is conditioned on Allegiant committing to fund
21 where no superior offer has been proffered. Thus, the Debtor will not be obligated to pay the break-
22 up fee unless the Allegiant Investors commit to fund and its “stalking horse” offer has been followed
23 by further and superior bidding. Should there be a further, higher bid, added value will have accrued
24 to the estate through the process.

25 **D. The Break-Up Fee Is In the Best Interest of the Estate, Creditors, and Equity Holders**
26 **Alike**

27 The break-up fee is appropriate, even if analyzed under a more exacting level of scrutiny. In
28 *In re America West Airlines, Inc.*, 166 B.R. 908 (Bankr. D. Ariz. 1994), for example, the court

1 commented that “this Court declines to follow other Bankruptcy Courts’ opinions where break-up
2 fees are treated as another topic of corporate negotiation without reference to *what in fact is in the*
3 *best interest of the estate.*” *Id.* at 912 (emphasis added). Here, the presence of the Allegiant
4 Investors has been, and will continue to be, in the best interest of and to the benefit of the estate,
5 creditors, and equity holders alike.

6 The AHEC contends that the break-up fee contained in the Allegiant Investors offer will
7 either chill bidding due to a required overbid or will result in a depletion of assets by payment of the
8 breakup fee. This assertion is not well-taken. The history of this case demonstrates that no party
9 stepped up to the plate until the Allegiant Investors emerged. Prior to the introduction of the
10 Allegiant Investors, the estate assets were shunned, competing bidders were scarce, and, as a result,
11 the estate’s assets were seriously undervalued.⁴

12 The Allegiant Investors provides the estate with an alliance of seven reputable institutions.
13 Through these institutional investors’ involvement, the estate’s potential value has been substantially
14 increased in the eyes of potential competing bidders. The continued involvement in the sale process
15 by the Allegiant Investors, therefore, is critical to maintaining this current level of interest and in
16 inducing additional competing bidders. As such, any break-up fee provision in the Allegiant
17 Investors’ proposal is more than merited, as it is critical to the continued inducement of other bidders
18 and bidding generally. Indeed, under the *America West* test, the need to induce interest by bidders in
19 undervalued, and underappreciated bankruptcy estate is the classic case for approval of a break-up
20 fee. *Cf. In re America West Airlines, Inc.*, 166 B.R. 908 at 913 (refusing a break-up fee where the
21 break-up fee would not encourage any further bids where the estate had been “thoroughly marketed”
22 the estate was otherwise profitable and thus attractive to bidders).

23 Allegiant’s offer results in significant benefits to the Debtor, its creditors and shareholders.
24 The terms of the LOI provide for immediate financing so that the Debtor will be able to pay the
25 senior secured lenders and pave the way for the Debtor’s reorganization. The Allegiant Investors’

26 ⁴ In fact, interested parties like Gateway were content to sit on the sidelines and refused to "up the
27 ante" until other parties had submitted their best offers. *See* Transcript of Deposition of Robert J.
28 Cresci, August 22, 2006, at 39:13-23, attached as Exhibit "B" to the Declaration of Steven T. Hoort
(Docket No. 569). Only after the Debtor accepted the Allegiant Investor's offer did Gateway come
forward with a proposal they now allege is the most favorable.

1 continued presence and ongoing alliance with the estate will encourage other interested bidders and
2 thereby will benefit the estate, creditors, and equity holders alike.

3 **E. The Break-Up Fee Provides Both Quantitative and Qualitative Benefits to the Debtor**

4 The Third Circuit has adopted the standard of Bankruptcy Code section 503(b) in analyzing
5 break-up fees. *See In re O'Brien*, 181 F.3d at 535 (holding that the allowability of break-up fees,
6 “like that of other administrative expenses, depends upon the requesting party’s ability to show that
7 the fees were actually necessary to preserve the value of the estate”). That section requires the
8 proponent of an administrative expense to prove that payment of such a cost or fee provides an
9 actual benefit to the estate and are necessary to preserve the value of estate assets. *Id.* at 532-33.
10 The Third Circuit has stated that a breakup fee provides the requisite benefit to the estate if the
11 break-up fee induces more competitive bidding, “such as by inducing a bid that would otherwise not
12 have been made and without which bidding would have been limited.” *Id.* at 537.

13 The Allegiant Investors’ offer proposes an arrangement that is beneficial to the Debtor and its
14 constituents, and is based on its valuation of the Company. In fact, the Allegiant offer proposes
15 conversion at a premium per share price. Allegiant would not have submitted its offer absent the
16 provision for a break-up fee. *See* Declaration of Paul J. Couchot in support of the Motion ¶ 4. Since
17 acceptance of the Allegiant Investors’ offer, several parties have expressed an interest in submitting
18 competing bids. As such, the break-up fee has induced, and is likely to continue to induce
19 competitive bidding and thus is necessary to both preserve as well as enhance the value of the estate.

20 Qualitative considerations are relevant as well to the analysis of value preservation. As
21 stated above, if Allegiant had been content to submit a “bargain basement” financing proposal, it
22 would have merely matched the terms of the Counterproposal. Instead, the Allegiant Investors
23 submitted a financing offer based on its assessment of the true underlying value and future prospects
24 of the estate. Seeking to nurture these future prospects, Allegiant proposed a conversion rate at a
25 premium of \$5.50 per share. The Allegiant Investors also insisted that before the Debtor accepted an
26 offer from Allegiant, it must give all interested bidders the opportunity to submit competing offers of
27 financing. It was only after this specific bidding period terminated that the Debtor assessed the bids
28 and accepted the Allegiant Investors’ offer. Had the Allegiant Investors not appeared on the scene,

1 these competing bids would never have materialized and the estate assets would have remained
2 undervalued. Indeed, without the continued participation of the Allegiant Investors, it is highly
3 possible that the *status quo ante* will again rule the day. As such, the Allegiant Investors’ offer—
4 including the proportionally minimal break-up fee—is “actually necessary to preserve the value of
5 the estate.” *Id.* at 535.

6 Qualitative factors such as this are otherwise important in consideration of the business
7 judgment test for the permissibility of break-up fees. *Cf. In re Exide Technologies*, 340 B.R. 222
8 (Bankr. D. Del. 2006) (holding that under the business judgment test, the qualitative benefits alone
9 were enough to support the debtor’s decision). Here, Allegiant’s higher offer—based on value rather
10 than what the non-competitive market could bear—introduced a viable “stalking horse” offer into
11 the process where there initially was no competition. Likewise, Allegiant’s fair and forthright offer
12 has discouraged the bidding strategies of the AHEC and Gateway, designed to suppress value by
13 holding back truly competitive bids until late in the process. Allegiant’s offer encouraged fair and
14 open bidding, and the accompanying break-up fee thus finds even stronger support under the
15 business judgment test.

16 **F. The Break-Up Fee is Part of a Financing Arrangement Specifically Approved by the**
17 **Bankruptcy Code**

18 Bankruptcy Code section 364 specifically allows the post-petition financing arrangement
19 proposed by the Allegiant Investors. It is true that any such financing arrangement will implicate, to
20 some extent, the terms of an eventual plan of reorganization and the capital or debt structure of the
21 emerging company. As explained below, however, terms of the financing here are customary for
22 financing of this nature. In addition, the conversion to equity is expected to take place pursuant to a
23 plan of reorganization.⁵

24 AHEC’s argument that Allegiant’s offer constitutes an impermissible *sub rosa* plan of
25 reorganization rings hollow in light of the AHEC Offer, which implicated the Debtor’s future capital
26 structure much more than the Allegiant Offer. Furthermore, the AHEC fails to identify exactly what
27 protection is being denied as a result of the court’s approval of the break-up fee. “In addressing the

28 ⁵ If this type of financing is truly a *sub rosa* plan, why did AHEC even make such an offer?

1 questions of *sub rosa* plans, ‘the objector must *specify exactly* what protection is being denied.’”
2 *Motorola, Inc. v. Official Committee of Unsecured Creditors (In re Iridium Operating LLC, et al.)*,
3 2005 U.S. Dist. LEXIS 5483, *30-31 (S.D.N.Y. 2005) (citing *In re Continental Airlines, Inc.*, 780
4 F.2d 1223, 1226 (5th Cir. 1986) (emphasis added). The AHEC has failed to identify how approval
5 of the break-up fee denies any parties the protections of the confirmation process. In fact, the AHEC
6 and all other interested parties will have full opportunity to object to the proposed financing
7 arrangement and any proposed plan incorporating the same. Furthermore, this Court has terminated
8 the exclusivity period, so the AHEC can submit a competing plan of reorganization if it so desires.
9 Thus, the AHEC’s objection based on an impermissible *sub rosa* plan is procedurally infirm.

10 Even if such an argument were proper here, it is unsupported by the law. Court have
11 approved postpetition financing arrangements containing conversion features. For instance, in *In re*
12 *Mid-State Raceway, Inc.*, 323 B.R. 40 (Bankr. N.D.N.Y. 2005), a case cited by the AHEC, the court
13 actually approved a \$1.2 million post-petition financing arrangement which allowed for conversion
14 into 18% of the reorganized debtor’s common stock. *Id.* at 46, 61-62; *see also In re Defender Drug*
15 *Stores, Inc.*, 145 B.R. 312, 317 (9th Cir. BAP 1992) (approving postpetition financing arrangement
16 under Section 364 over *sub rosa* plan argument). In fact, the debtors in *Mid-State* accepted the
17 proposed financing arrangement over another bid based on its consideration of a number of
18 qualitative factors including, among other things, the “legitimacy” of the offeror, the provision for
19 payment of creditors, and the allowance for bidding from other parties. *Mid-State Raceway*, 323
20 B.R. at 45-46.

21 The fact that the conversion price is incorporated into the terms of the financing arrangement
22 does not bar approval. Instead, the conversion feature under the Allegiant offer is expected to occur
23 only pursuant to an accepted plan. Thus, the protections of the confirmation process will be afforded
24 to any affected parties. In addition, the provision for payment of a make-whole premium is designed
25 to afford the Allegiant Investors the benefit of their bargain and its terms will be negotiated at final
26 documentation.

27 It bears noting again that in addition to the economic benefits of the Allegiant offer, various
28 qualitative factors support the acceptance of Allegiant’s offer over the AHEC Offer. *See Mid-State*,

1 *supra*, at 45-46 (detailing quantitative and qualitative factors considered in accepting financing
2 offer). As stated above, the Allegiant Investors have demonstrated that they are not an opportunistic
3 bidder in this case, but have submitted a financing offer based on their valuation of the estate and
4 have added value to the Debtor, its creditors, and its equity holders. The Allegiant Investors have
5 also ensured that all interested bidders were given the opportunity to submit competing offers of
6 financing. This legitimacy adds value to the process, encourages participation by other interested
7 third parties, and bolsters confidence in the Debtor's reorganization prospects.

8 **VI. THE ALLEGIANT INVESTORS' LEGAL FEES AND DUE DILIGENCE EXPENSES**
9 **BENEFIT THE ESTATE AND SHOULD BE APPROVED**

10 The payment of a bidder's actual attorneys' fees and due diligence expenses can be properly
11 paid as an administrative expense under Bankruptcy Code section 503(b)(1) when the bidder's
12 participation in competitive bidding confers a benefit to the estate. *See In re Tama Beef Packing,*
13 *Inc.*, 290 B.R. 90 (8th Cir. BAP 2003). Here, Allegiant's offer clearly confers a benefit to the estate
14 by its favorable terms. Upon approval and funding, the Debtor, the creditors and the shareholders
15 stand to benefit considerably as set forth above. In addition, the payment of Allegiant's legal fees is
16 capped at \$100,000 and due diligence expenses capped at \$35,000 in the event the financing
17 arrangement is not funded.

18 Moreover, AHEC should be estopped from objecting to this provision. The AHEC Offer
19 similarly required the payment of *all* fees and expenses of AHEC counsel, plus an additional
20 \$100,000 monthly payment. Cohen Decl. ¶ 6. Thus, it is ironic that the AHEC objects to the
21 payment of Allegiant's proposed fees, when payment of fees under AHEC's offer would *alone* have
22 cost the estate even more than the break-up fee at issue here.

23 **VII. CONCLUSION**

24 The AHEC comes before this Court with a "sore loser" mentality and objects to the Allegiant
25 Investors' offer despite having been given *months* to negotiate and submit a superior offer. Instead,
26 the only offer submitted by AHEC conditioned its financing on acquiring control of the Debtor. The
27 AHEC now attempts to frustrate the good faith efforts of an independent third party to add
28 significant value to the Debtor, its creditors and its equity holders. The attacks on the break-up fee

1 and due diligence expenses are not supported by the law nor the clear facts underlying this case. The
2 Allegiant Investors, on the other hand, have presented the Debtor with a proposal far superior to that
3 made by any other bidder, and seek to support the Debtor in its efforts to satisfy its obligations to its
4 creditors and its duties to increase value for its equity holders. The proposed fees are reasonable and
5 provide contingent compensation equivalent to the risk undertaken by the Allegiant Investors in
6 proceeding with the proposed financing. The AHEC has failed to provide any evidence to the
7 contrary. Accordingly, the Motion should be approved.

8
9
10 Dated: August 28, 2006

BAKER & McKENZIE LLP

11
12 By: /s/ Ali M.M. Mojdehi
Ali M.M. Mojdehi

13 Counsel for the Allegiant Investor Group
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

EXHIBIT “A”

1 PAUL J. COUCHOT - State Bar No. 131934
GARRICK A. HOLLANDER - State Bar No. 166316

2 **WINTHROP COUCHOT**
3 **PROFESSIONAL CORPORATION**

4 660 Newport Center Drive, Ste. 400
Newport Beach, CA 92660

5 Telephone: (949) 720-4100
Facsimile: (949) 720-4111

6 General Insolvency Counsel for
Debtor and Debtor-in-Possession

7
8

9 **UNITED STATES BANKRUPTCY COURT**
10 **SOUTHERN DISTRICT OF CALIFORNIA**

11

12 In re

13 SERACARE LIFE SCIENCES, INC.,
14 a California Corporation (d/b/a Therasource
15 International; f/k/a The Western States
16 Group, Inc.; d/b/a Biomedical Resources, a
17 division of SeraCare Life Sciences, Inc.;
18 d/b/a Genomics Collaborative, a division of
19 SeraCare Life Sciences, Inc.; f/k/a Southwest
Biological Services Western States Plasma
Co., Inc.; d/b/a Boston Biomedica, Inc.; d/b/a
SeraCare Bioservices; and d/b/a SeraCare
Diagnostics),

20 Debtor and Debtor-in-
21 Possession.

Case No. SD 06-00510 LA

RFS No. MRB-001

Chapter 11 Proceeding

**DECLARATION OF ROBERT CRESCI IN
RESPONSE TO REPLY OF AD HOC
EQUITY COMMITTEE REGARDING
MOTION TO LIFT STAY AND,
ALTERNATIVELY, TO TERMINATE
EXCLUSIVITY**

DATE: August 24, 2006

TIME: 3:00 p.m.

PLACE: Courtroom 2

22

23

24

25

26

27

28

DECLARATION OF ROBERT CRESCI IN RESPONSE TO REPLY OF AD HOC EQUITY COMMITTEE
REGARDING MOTION TO LIFT STAY AND, ALTERNATIVELY, TO TERMINATE EXCLUSIVITY

1 I, Robert Cresci, declare and state as follows:

2 1. I am the Chairman of the Board of Directors of SeraCare Life Sciences, Inc., the
3 debtor in possession herein (the "Debtor"). I am also a member of the Committee of Independent
4 Directors that was formed by a vote of the full board of directors at the same time that the board
5 asked certain members of its former management team to resign their positions as board members
6 in connection with the termination of their employment or consulting relationships with the
7 Debtor. I am over the age of eighteen and I am a resident of New York. The facts stated herein
8 are within my personal knowledge and if called upon to testify to the same I could and would
9 testify competently thereto. The purpose of this declaration is to respond to certain inaccuracies
10 or mischaracterizations set forth in the Declaration of Scott M. Tillman ("Tillman Declaration")
11 filed with the Court on August 18, 2006, which I believe were not asserted in Mr. Tillman's
12 declaration supporting the AHEC's moving papers.

13 2. As I have stated in prior declarations, I have more than 33 years of direct
14 investment and management experience including investment and valuation analysis, turnaround
15 work and development of corporate strategies as well as merger and acquisitions. I have
16 completed financings and mergers in a broad range of industries. I have served as a company
17 director, lead director or chairman of the board of more than 25 companies. My current position
18 is Managing Director of Pecks Management Partners Ltd. ("Pecks") where I am directly
19 responsible for the selection, valuation and negotiation of investments, and the monitoring of
20 those investments for portfolios totaling approximately \$150 million. I hold an MBA in finance
21 from Columbia University and a BS in Engineering from the United States Military Academy at
22 West Point. I served four years on active duty as an infantry officer, two of them in Vietnam.

23 3. I personally own approximately 6,000 shares of common stock of the Debtor. As
24 stated, I am the managing director of Pecks, which is the investment advisor for four pension
25 funds that own an aggregate of 1,142,038 shares of common stock of the Debtor. Under the
26 Securities and Exchange Commission rules, the Debtor is required to report those shares as being
27 beneficially owned by me, even though I do not have an economic interest in these shares.

28

-2-

1 serious parties. As I stated in prior declarations, the Debtor believes that the proposed transaction
2 with the Allegiant Group will allow the Debtor to propose a plan providing a 100% distribution to
3 all creditors whose claims are not subject to subordination. Consequentially, I believe the plan
4 process is being advanced.

5 8. I disagree with Mr. Tillman's assertion that the AHEC had made a "rights
6 offering" proposal. In fact, to my knowledge, the AHEC has never provided any of the material
7 terms, such as price or size of the offering, to the Debtor for consideration.

8 9. I disagree with the AHEC's assertion that the Debtor has abdicated its role in the
9 plan process because the Debtor's plan must be reasonably acceptable to the Allegiant Group.
10 Unlike the AHEC, who attempted to dictate all of the plan's material provisions in connection
11 with its financing proposal, the Allegiant Group has not attempted to dictate any plan terms other
12 than those in the term sheet.

13 10. I disagree with the AHEC's assertion that the Debtor's failure to hold an annual
14 shareholder meeting is an attempt by the Independent Committee to entrench their positions. It is
15 my experience that it is not customary or practical for a public company to hold an annual
16 meeting of shareholders for the purpose of electing directors when, like the Debtor, the company
17 is not current in its periodic filings with the Securities and Exchange Commission. This is
18 because the company must send an annual report (i.e. a 10-K) to all of its shareholders along with
19 a proxy statement (if soliciting proxies) or an information statement (if not soliciting proxies).
20 Because it does not have audited financial statements, the Debtor cannot complete its 10-K. Thus,
21 although holding an annual meeting prior to filing the 10-K is possible, it would certainly not be
22 without significant expense and distraction to the bankruptcy estate.

23 11. I disagree with the AHEC's assertion that the Independent Committee does not
24 hold meetings on a regular basis and that the Independent Committee has made no efforts to fill
25 board vacancies. In fact, the Independent Committee has met more than ten (10) times since its
26 formation on March 13, 2006. Further, as disclosed in the Debtor's prior motions regarding its
27 hiring of Sue Vogt as its Chief Executive Officer, the Debtor expects to appoint Ms. Vogt to fill

1 one of its two vacancies on the Board. The Independent Committee is also engaged in a search
2 process for additional directors.

3 I declare that the foregoing is true and correct under the penalty of perjury.

4 Executed this 22nd day of August 2006, in New York, New York.

5

6

/s/
Robert Cresci

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28

EXHIBIT “B”

1 CRESCI

2 would you also consider whether or not you
3 will identify this individual?

4 MR. METCALF: Oh, sure. As a
5 general matter, I have no problem with the
6 documents unless there's a confidentiality
7 restriction, which I have no personal
8 knowledge of.

9 MR. HOORT: And which the
10 witness also has no personal knowledge of.

11 MR. METCALF: That may be the
12 case.

13 Q. What was the AMBIGUITY in the
14 proposal as to pricing?

15 A. They said they were going to
16 offer us a \$6 conversion price, and then
17 withdrew it and said they were at 5.50 but
18 perhaps would go higher. But at the moment
19 they were not going to go forward. They would
20 rather be in second place.

21 Q. And so that's where the
22 negotiations with them stopped?

23 A. Correct.

24 Q. Going back to the areas on
25 which -- the topics in which examination is