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Buying and Selling Businesses in Insolvency Proceedings

As the economy recovers from the lingering financial crisis, lenders that in the last several years had few options with respect to distressed borrowers are now finding a robust market for the sale of going-concern companies. Private equity funds are under pressure to invest their capital and financial institutions and other lenders are aggressively competing for loans. In this environment, the constituent parties frequently utilize the protections of a federal insolvency proceeding to market and convey businesses. The business assets are transferred as ongoing concerns free and clear of liens, claims, and encumbrances, thereby restructuring the target's balance sheet while reducing the risk of trailing liabilities which burden traditional asset purchases. This article provides an outline of the process followed in Chapter 11 bankruptcy cases, and highlights key issues involved.

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In the first two decades after the 1978 passage of the United States Bankruptcy Code[1] (the "Code") reorganization of businesses under Chapter 11 occurred generally as Congress intended. The debtor's objective was confirmation of a reorganization plan which occasionally restructured the debtor's secured obligations and usually compromised its unsecured obligations. The objective was to negotiate a "new deal" that paid creditors as much of their obligations as possible but also allowed the equity owners to retain their capital interests.

In recent years, however, the vast majority of Chapter 11 cases have proceeded much differently.

BACKGROUND: THE CHANGED PLAYING FIELD

More recent cases have resulted in the sale of the debtor's assets outside of the ordinary course of business under Code Section 363, usually within a very short period of time after the filing of the case.

Factors in Trend to Asset Sales. This trend has arisen for two reasons:

1. *Overleveraging:* In the era of easy money, businesses became overleveraged with secured claims swamping company balance sheets. When a debtor suffered operational distress, the secured lenders not only had significant secured claims but often also had the largest unsecured claim in the case. It became very difficult for debtors to restructure the secured debt and negotiate a large enough discount of the unsecured claims to allow the business to continue with the owners retaining their equity. Debtors discovered that dealing with a single under-secured lender or consortium of lenders was much more difficult than negotiating a compromise with a committee that represented the claims of many different trade creditors who had a stake in the survival of a customer. Because the under-secured lenders often dominated the total amount of unsecured claims, consensual reorganization plans became very hard to achieve; this, in turn, caused the costs of contested Chapter 11 cases to skyrocket, making it difficult, if not impossible, for the owners to retain their equity interests.

2. *Conditional Post-Petition Financing Agreements:* The costs of a Chapter 11 case through confirmation of the plan of reorganization can

[1] 11 U.S.C §§101-1532. Unless otherwise specified, all "Section" references in this article are to sections of the Bankruptcy Code.

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be enormous, while the confirmation itself is not a certainty. With experience, lenders came to realize that they could control the course of a case through their agreement to provide essential post-petition financing to allow a debtor to fund post-petition operations. Lenders began to condition post-petition financing on an agreement to offer the debtor's assets for sale under Section 363 within a short time after filing. By doing so lenders opted to avoid the significant costs of funding a protracted case with an uncertain outcome in favor of a process that required minimal additional investment and had a defined outcome. Most debtors were significantly overleveraged with no unencumbered assets, so they were unable to obtain debtor-in-possession financing from third parties. This left them with few options other than to accede to their lender's demands and agree to a sale of the assets of the enterprise as a going concern under Section 363.

Changes in Jurisprudence. The jurisprudence regarding Section 363 sales has changed over the last 30 years as well. One of the earliest cases to address the scope of a debtor's ability to utilize Section 363 to sell assets was *In re White Motor Credit Corp.*[2] In *White Motor Credit Corp.*, the Bankruptcy Court for the Northern District of Ohio held that a debtor could not use Section 363(b) to sell all or substantially all of the debtor's assets except in the case of an "emergency" because such a sale would deny creditors the protections of the Chapter 11 plan confirmation process.[3] In so finding, the court relied on the standard set forth in the Code's predecessor—the Bankruptcy Act—which permitted disposition of the bankruptcy estate's property only in cases of "emergency" or "perishability."[4]

In one of the next cases to address the scope of a debtor's ability to sell assets under Section 363, *Lionel*,[5] the debtor sought to sell its 82 percent interest in a solvent, non-debtor company named "Dale" in a sale under Section 363 of the recently enacted Code.[6] Lionel filed a motion under Section 363(b), seeking to sell its interest in Dale in order to fund its plan of reorganization. The plan was filed shortly after the sale motion and was conditioned upon a sale of Lionel's interest in Dale and a distribution of the sale proceeds to creditors.[7]

At the hearing on the sale motion, the CEO of Lionel and the Vice President of Lionel's investment banker testified that the price to be paid for the Dale stock was "fair," but that there was no reason that the sale couldn't be accomplished as part of the reorganization plan.[8] In fact, the sole reason for Lionel's sale motion was the insistence of the unsecured creditors' committee, which wanted to turn the Dale asset into a "pot of cash" to be used to pay creditors.[9] The bankruptcy court approved the sale, making no formal findings of fact, but simply noting that cause to sell was sufficiently shown by the unsecured creditors' committee's insistence upon it.[10]

The equity committee, which represented the interests of Lionel's public shareholders, appealed the bankruptcy court's order approving the sale.[11] The equity committee argued that the sale of assets prior to approval of a plan deprived creditors of disclosure of information about the plan, solicitation, and the right to vote upon acceptance of a plan, and divested Lionel of assets that could have been used as the cornerstone for a sound plan.[12] The district court affirmed the bankruptcy court's decision, and the equity committee appealed to the Second Circuit Court of Appeals.

The Second Circuit Court of Appeals distinguished the standard under the Code from the "emergency" or "perishability" standard employed by courts under the Bankruptcy Act.[13] However, the Court of Appeals also found that Section 363 didn't provide the bankruptcy court with *carte blanche* authority to approve sales of assets under Section 363.[14] Instead, the appellate court found that the language of Section 363, as well as the legislative history of the Code section, indicated that "there must be some articulated business justification, other than the appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business" in order for a bankruptcy court to approval such disposition under Section 363(b).[15]

The Second Circuit Court of Appeals thus held that a judge ruling on a motion to sell property under

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[2] 14 B.R. 584 (Bankr. N.D. Ohio 1981).

[3] Id. at 590.

[4] See id. ("In any event, it would appear that Congress left the "emergency" exception intact and its application is appropriate in this case.")

[5] Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063 (2d Cir. 1983).

[6] Id. at 1065.

[7] Id.

[8] Id.

[9] Id.

[10] Id. at 1065-66.

[11] Id. at 1066.

[12] Id.

[13] Id. at 1069.

[14] Id.

[15] Id. at 1070.

Section 363(b) must "expressly find from the evidence presented before him at the hearing a good business reason to grant such an application."[16] This has since become commonly known as the "business judgment standard." In considering the "business judgment standard," the Second Circuit Court of Appeals found that judges should look to factors including, but not limited to:

- Proportionate value of the asset to the estate as a whole;
- The amount of time elapsed since the filing;
- The likelihood that a plan of reorganization will be proposed and confirmed in the near future;
- The effect of the proposed disposition on future plans of reorganization;
- The proceeds to be obtained from the disposition vis-à-vis any appraisals of the property;
- Which of the alternatives of use, sale, or lease the proposal envisions; and
- Whether the asset is increasing or decreasing in value.[17]

Applying these factors to *Lionel*, the Second Circuit Court of Appeals found that the sale had been improperly approved where the only reason advanced for granting the sale was the insistence of the unsecured creditors' committee.[18] The *Lionel* case was therefore remanded to the district court with instructions to remand to the bankruptcy court for further proceedings consistent with the Second Circuit Court of Appeals' ruling.[19]

Lionel, then, evidenced the first move in a shift away from the "emergency" or "perishability" standards employed under the Bankruptcy Act, in favor of a more flexible standard to be employed under the then-recently-enacted Code. In the years following the *Lionel* decision, courts have considerably broadened a debtor's ability to sell assets pursuant to Code Section 363. While the "business judgment standard" first articulated in *Lionel* is still relevant, courts since *Lionel* have increasingly utilized that standard to approve pre-plan confirmation sales of substantially all of a debtor's assets in a wide range of situations not necessarily involving emergencies.[20] The business judgment standard has been distilled into a standard that looks to what is in the best interest of creditors.

[16] Id. at 1071.

[17] Id.

[18] Id.

[19] Id. at 1072.

[20] See e.g., In re Chrysler LLC, 405 B.R. 84, 96 (Bankr. S.D.N.Y. 2009); In re Gen. Motors Corp., 407 B.R. 463, 491-92 (Bankr.S.D.N.Y. 2009).

THE PLAYERS

Most Chapter 11 cases have a similar cast of participants. The United States Trustee, whose position was created by statute to oversee bankruptcy cases, plays a significant role in motions to sell a debtor's assets. In addition to the debtor and lenders and their respective counsel, accountants, and other financial advisors, a committee of unsecured creditors is appointed by the U.S. Trustee to represent the interests of unsecured creditors in the case. The committee is authorized to retain counsel and other professional advisors at the debtor's expense.

As the dynamics of Chapter 11 cases have evolved over the years, so has the role of the committee. Instead of negotiating the terms of a plan of reorganization which is presented to creditors for a vote with the committee's endorsement, in most cases today the committee attempts to negotiate with the lender over a carve-out from the sale proceeds to allow unsecured creditors (who would otherwise receive little or nothing) to receive a greater distribution. The U.S. Trustee in many jurisdictions supports the committee's efforts to obtain a carve-out. The committee's leverage comes from its ability to object to all aspects of the sale process. During the course of the negotiations, a lender will weigh the additional costs and potential delay that would be precipitated by the potential fights with the committee against the requested carve-out, and often concludes that agreeing to a reasonable carve-out is the better option.

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The carve out is typically approved in the bid procedures order and sale order discussed below, and on occasion, will bypass senior priority claims, such as claims of taxing authorities, and provide funds to unsecured claimants who would otherwise not be entitled to them under the priority scheme of the Code. There is case law holding that a lender may bypass senior priority claims in this manner on the theory that a secured lender may "gift" proceeds to others, including junior creditors, in any manner it chooses.[21]

[21] See, e.g., In re SPM Mfg. Corp., 984 F.2d 1305, 1313 (1st Cir. 1993) ("While the debtor and the trustee are not allowed to pay nonpriority creditors ahead of priority creditors . . . creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including share them with other creditors."); In re World Health Alternatives, Inc., 344 B.R. 291 (Bankr. D. Del. 2006).

However, recent case law suggests that a lender may not make such "gifts" to junior creditors within the context of a Chapter 11 plan,[22] as distinguished from a sale under Section 363 outside of a plan.

Other key players in the Section 363 sale process include the bankruptcy court; the debtor's financial advisor, who usually markets the company and manages the sale process; a stalking horse bidder, who sets the floor price; and the other competing bidders. More will be said about these parties below.

THE PROCESS

The Marketing Process. After a case is filed, the debtor's financial advisor will begin the marketing process.[23] An electronic "data room" will be created where key due diligence information for interested parties will be aggregated; this allows the financial advisor to determine which parties access the data room and what information they review. A one page teaser letter is prepared and sent to all of the parties listed in the financial advisor's data base and to any other potential purchasers. The financial advisor may also prepare a sales memorandum or "book," which provides detailed information about the target, including its competitors and their respective market share. The financial advisor will prepare a nondisclosure and confidentiality agreement, which must be signed before any party receives the book or access to the data room. This is particularly important when the target's competitors may be among the most interested potential purchasers.

The stalking horse bid sets the floor price for the transaction. The stalking horse binds itself to close the transaction upon the terms of its bid, set forth in an asset purchase agreement, provided no other party makes a higher or otherwise better bid for the assets.

Selecting the right financial advisor may mean the difference between a successful sale process and a mediocre one. A financial advisor with experience in the debtor's industry likely will be familiar with the major strategic and financial buyers, and may have dealt with them in prior sale processes. An experienced financial advisor also will be able to highlight potential operational synergies or competitive factors of particular interest to specific purchasers.

The Stalking Horse Bidder. The financial advisor's initial objective is to identify a "stalking horse" bidder.[24] The stalking horse bid sets the floor price for the transaction. The stalking horse binds itself to close the transaction upon the terms of its bid, set forth in an asset purchase agreement, provided no other party makes a higher or otherwise better bid for the assets. In exchange, the stalking horse bidder usually receives a number of significant benefits, including a break-up fee and perhaps an expense reimbursement, and other bid protections. Courts will usually approve a break-up fee if the fee is necessary to facilitate a sale and is reasonable in relation to the purchase price.[25] The break-up fee customarily ranges from 3 percent to 5 percent of the price offered by the stalking horse and is paid to the stalking horse bidder from the proceeds of sale if a competing bidder closes the transaction. The break-up fee induces the stalking horse to spend the time and expense to undertake the due diligence necessary to make a binding, unconditional offer for the debtor's assets and business.

Occasionally, in addition to a break-up fee, a stalking horse bidder may ask for a reimbursement for expenses actually incurred in connection with the transaction, not to exceed a certain amount. Some courts are reluctant to approve both a break-up fee

[22] DISH Network Corp. v. DBSD N. Am. Inc. (In re DBSD N. Am. Inc.), 634 F.3d 79 (2d Cir. 2011); In re Armstrong World Industries, Inc., 432 F.3d 507, 514 (3d Cir. 2005). See also, In re Iridium Operating, LLC, 478 F.3d 452 (2d Cir. 2007) (finding that gift made in settlement of a claim dispute was not permissible because the property "gifted" was not the property of the gifting creditor).

[23] This article addresses the sale of businesses under Bankruptcy Code Section 363. However, businesses are often sold pursuant to roughly equivalent processes under state law. These sales can be made through judicially supervised statutory assignments for the benefit of creditors, see, e.g., Wis. Stat. Ch. 128; Fla. Stat. Ch. 727, or under common law assignments, such as those employed in Illinois, which are non-statutory and are not court supervised.

[24] Occasionally, a potential purchaser is identified prior to the filing of the Chapter 11 proceeding and a sale proceeds without a stalking horse bidder. The debtor may have been in a workout with its lender, and an investment banker retained to explore a sale as part of the workout process. In such cases the debtor files a motion to approve a sale to a single purchaser subject to objections if a higher or otherwise better bid is made. This process risks drawing objections from the unsecured creditors' committee and the U.S. Trustee, who may assert that the sale process is too expedited, and is a strategy often employed either in very small cases or where there are demonstrable emergent circumstances. For a case in which an expedited sale to single purchaser drew vigorous objection, see In re Fisker Automotive Holdings, Inc., Case No. 13-13087 (KG), 2014 Bankr. LEXIS 230 (Bankr. D. Del. Jan. 17, 2014), which is discussed infra in text at note 32.

[25] See In re Metaldyne Corp., 409 B.R. 661 (Bankr. S.D.N.Y. 2009).

and an expense reimbursement. Other courts will not approve break-up fees at all, choosing instead to authorize payment to the stalking horse of the actual expenses incurred, again up to a capped limit. Although they are in the minority, still other courts resist authorizing any break-up fee or expense reimbursement, reasoning that the work to become the stalking horse was already done prior to the request and no further inducement is necessary.[26] However, these courts seem to ignore the fact that the stalking horse will be obligated to close the transaction if no other bids are made and therefore must tie up the necessary capital for the duration of the sale process to enable it to do so.

Other bid protections frequently requested by the stalking horse include setting the initial overbid amount for competitive bids, establishing subsequent bid increments, and having significant input into the form of the asset purchase agreement that other bidders must use. Additionally, a stalking horse may ask to be exempted from making the bid deposit required of other bidders and to be able to credit bid the amount of the break-up fee in any auction. Finally, the stalking horse almost always requires that the bid procedures and sale motions and orders (discussed below) are in forms satisfactory to it.

The strategy of deciding to seek stalking horse status varies among bidders. Many bidders seek stalking horse status to cover the necessary up-front costs required to evaluate the proposed transaction. This is especially true if the bidder is evaluating multiple transactions at the same time. Other bidders prefer not to become a stalking horse, preferring instead to keep their interest confidential until later in the sale process.

Once the stalking horse is identified, the debtor will file a motion seeking approval of the stalking horse bid, the break-up fee and expense reimbursement if applicable, the form of the asset purchase agreement, and the bid procedures to be used if there are competing offers. In addition, the motion will request a date for a hearing to approve the sale either to the stalking horse or to a competing bidder who submits a higher or otherwise better bid. Usually, the motion will also seek authority pursuant to Section 365 to assume and assign to the ultimate purchaser executory contracts and leases designated by the purchaser prior to the closing of the transaction. Finally, the motion will seek approval of any carve-out from the purchase price to be paid to unsecured creditors.

The asset purchase agreement will provide for the transfer of assets free and clear of any and all liens, claims, encumbrances, and interests on an "as is, where is" basis, most often in consideration of an all-cash purchase price plus assumption of certain specified liabilities. The agreement often also provides for a working capital adjustment based upon the amount of working capital assets existing at closing as compared to the amount of the same assets present at the time the agreement is executed. Finally, the agreement provides for the sale to be conditioned upon the entry of the bid procedures and sale orders, both in a form acceptable to the purchaser; provides for remedies in the event of a default; and provides for the basis for termination of the agreement by either party.

Bid Procedures. The bid procedures described in the bid procedures motion address issues such as time, place, and conduct of any auction, and will enumerate the requirements to become a qualified bidder at any auction which may be held. To be a qualified bidder, by an established deadline parties usually must submit an asset purchase agreement in a form substantially similar to the stalking horse agreement (and marked to show changes from that agreement), with a purchase price of at least the stalking horse bid plus the overbid amount. Variations in the asset purchase agreement are factored in when evaluating bids. Where one party agrees to assume certain liabilities or executory contracts, its bid may be deemed higher or otherwise better than another party's which does not, because the net amount to the estate will be higher under the first party's offer.

Many bidders seek stalking horse status to cover the necessary up-front costs required to evaluate the proposed transaction. This is especially true if the bidder is evaluating multiple transactions at the same time.

In addition, to be a qualified bidder, a party usually must accompany its bid with a cash bid deposit (which can be up to 10 percent or more of the purchase price) and submit satisfactory evidence of the party's financial ability to close the transaction. Such evidence can range from the financial statements of a publically traded company making a bid, to bank statements or an unconditional loan commitment letter from a financial institution for other bidders.

The bid procedures also address whether bidders must appear in person at any auction and who—other than the lender, the debtor, the committee, qualified bidders, and their respective advisors—may attend the auction. Most often, the bid procedures provide

[26] See In re Reliant Energy Channelview LP, et al., 594 F.3d 200 (3rd Cir. 2010).

that members of the press and observers are excluded from the auction.

The bid procedures may offer the debtor's assets for sale in lots as well as the assets as a whole. The lots may be comprised of specific assets, such as all real estate and all machinery and equipment, or instead may describe specific divisions or lines of business. The objective is to seek offers for pieces of the business in order to compare the sum of them to offers for the whole enterprise.

Immediately after the approval of the bid procedures motion and through the date qualified bids must be submitted, the financial advisor continues to contact potential bidders to encourage them to make bids. The financial advisor will answer questions and stress the potential benefits and synergies which could arise from the purchase. Most importantly, the financial advisor will ensure that all parties desiring to make a bid timely meet the requirements of qualification.

One very important issue is whether the secured lender may be deemed a qualified bidder and credit bid its debt.

Credit Bidding. One very important issue is whether the secured lender may be deemed a qualified bidder and credit bid its debt. Section 363(k) specifically authorizes a secured creditor to credit bid its claim and offset the claim against the purchase price. However, the section is qualified by the phase "unless the court for cause orders otherwise."

In addressing this qualification, some courts have refused to limit a secured creditor's right to credit bid the full amount of its claim, finding that whatever amount the creditor bids defines the value of the collateral.[27] Courts employing this reasoning point out that a rational secured creditor would stop credit bidding if a competing bidder offered cash in excess of the "real" value of the collateral,[28] and that the right to credit bid ensures that a creditor's liens will not be extinguished for less than face value without the lender's consent.[29] Even the United States Supreme Court has held that a Chapter 11 "cramdown" plan cannot be confirmed if it provides for the sale of collateral free and clear of a creditor's liens, without permitting the creditor to credit bid at the sale; however, it has not addressed the extent to which credit bidding rights may be limited "for cause."[30]

Other recent cases have relied on the "for cause" language in Section 363(k) and called into question a creditor's right to credit bid the full amount of its claim. In a controversial footnote, the Third Circuit Court of Appeals stated in 2010 that

> a court may deny a lender the right to credit bid in the interest of any policy advanced by the Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment.[31]

In another very controversial decision, rendered in January 2014, the United States Bankruptcy Court for the District of Delaware held that a secured creditor who purchased $168.5 million of loan obligations for $25 million could only credit bid up to $25 million in a sale of the collateral securing its liens.[32] If followed, these cases could affect the ability of distressed debt funds, or "vulture funds," to purchase debt from traditional lenders at a deep discount and then attempt to credit bid the full amount of the debt at face in an attempt to buy the target business.

The Auction. Assuming there is at least one qualified bid in addition to the stalking horse bid, the parties then engage in an auction at the time and place set forth in the approved bid procedures. The auction is usually conducted by the financial advisor. Occasionally, if an acceptable stalking horse offer is not forthcoming, the parties may decide to proceed with an auction at which bidders participate without a stalking horse, called a "naked auction." In a naked auction, the financial advisor either sets a minimum opening bid at an amount approved by the secured lender, or the secured lender reserves the right withhold consent to the sale if the bids received are insufficient. Most often, however, the auction proceeds with a stalking horse and one or more other qualified bidders.

Conduct of the Auction and Auction Rules. The auction almost always begins with a general session at which all bidders are present and during which the financial advisor announces the opening bid and explains the

[27] See e.g., In re Submicron Systems Corp., 432 F.3d 448, 459-461 (3d Cir. 2006).

[28] Id.

[29] In re River Road Hotel Partners, LLC, 651 F.3d 642, 650-51 (7th Cir.2011).

[30] In re RadLAX Gateway Hotel, LLC et al., 132 S. Ct. 2065, 2073 (2012).

[31] In re Philadelphia Newspapers, LLC, 599 F.3d 298,316 n. 14 (3d Cir. 2010).

[32] *In re Fisker*, supra note 24; see also In re Free Lance-Star Publ'g Co. of Fredericksburg, VA, Case No. 14-30315-KRH (Dkt. No. 185) (Bankr. E.D. Va. Apr. 14, 2014) (limiting credit bidding rights where secured creditor did not have a lien on all assets to be sold and attempted to exercise excessive control over bidding process).

rules pursuant to which the auction will be conducted. This initial meeting and the subsequent proceedings are often transcribed by a court reporter so that the parties can refer to a transcript if there are later objections to the manner in which the auction was conducted.

The auction rules, which are often in writing and distributed to bidders, usually address the order of bidding and how that order may change from round to round based upon which bidder makes the highest bid in a round, and which bidders pass. The auction rules usually provide that all bids made must be in cash, unconditional, and irrevocable. The auction rules establish the minimum bid increments, set the time limit that each bidder has to decide whether to make a bid, and provide whether a bidder can pass in any round of bidding. In addition, the auction rules reserve the right of the financial advisor—usually in consultation with the debtor, the lender, and the committee—to require additional evidence of financial ability to close from any bidder at the then highest price bid as a condition to further participation in the auction. Finally, the auction rules set forth when and how the auction will be determined to be over. In most auctions, the auction rules may be modified during the course of the auction so long as the modifications don't conflict with the court approved bid procedures.

The manner in which the auction is conducted after the initial plenary session varies from case to case, but usually proceeds in one of two ways.[33] An auction may be conducted with all bidders in the same room, with the financial advisor seeking additional bids in each round of bidding until the highest or otherwise best bid (or combination of bids for the various lots) and the next highest or otherwise best bid is achieved. This is called an "open outcry" auction. Alternatively, the financial advisor meets privately with each bidder during a round, advises them of the high bid in the round, and informs them they have the right to decide to increase their bid or pass within time limit prescribed by the auction rules. In the first round, the auction begins with the highest qualified bid and continues in subsequent rounds until no new bids are made in a round. At that point, the highest or otherwise best bid (or combination of bids) in the preceding round is designated the winning bid and the next highest or otherwise best bid is designated as the back-up bidder.

Auction and Bidding Strategy. There are varying opinions about whether better results are achieved by allowing bidders to see their competition during the auction or by keeping the identity of the parties making specific bids confidential. Similarly, there are varying opinions about the optimal bid strategy to employ during the course of the auction. For example, is it better pass as often as possible and bid only the minimum bid increment to let other parties believe a bidder will continue as long as necessary to prevail, or instead to bid amounts in excess of the minimum in every round to make a dramatic statement to other bidders about one's financial resources? The variables—including the identity of the stalking horse bidder, the number and identity of the other bidders, the value of the assets and the resources of the bidders—change with each auction and make it virtually impossible to identify the single best alternative applicable to all situations. What may be optimal in one situation may not be so in another.

The auction continues until the highest or otherwise best bid is determined. Note that the standard should be *highest or otherwise best bid*, not highest and best bid, as a bid with a lower dollar amount but which provides for the assumption of executory contracts or specific liabilities, the retention of employees to avoid a plant closing liability, or which includes other provisions favorable to the estate may yield a better result than a facially higher bid. The bid procedures should always permit the financial advisor, usually in consultation with the debtor, the lender, and the committee, to make the determination of which bid is the highest or otherwise best in any round and at the end of the auction.

The bid procedures should always permit the financial advisor, usually in consultation with the debtor, the lender, and the committee, to make the determination of which bid is the highest or otherwise best in any round and at the end of the auction.

When the bidding is concluded the financial advisor announces the winning bid and the backup bid and declares the auction closed. The winning bidder and the backup bidder remain obligated under their respective asset purchase agreements until the earlier of a closing or an outside upset date in the event the closing is delayed for an extraordinary period of time which affects the value of the assets or the viability of the business. The other bidders' agreements terminate according their terms and their respective bid deposits are promptly returned. The deposits of the winning and backup bidders are retained until closing.

[33] On rare occasions, the financial advisor may solicit sealed bids and announce the winning bidder and back-up bidder based upon the ranking of the bids.

When Is the Auction Over? Although the answer to this question may seem obvious, it isn't necessarily as straightforward as one would think. As discussed in further detail below, auctions taking place under the Code and court-approved bidding procedures require court approval of the final auction results. Occasionally, a party will attempt to make a bid for assets after the closing of the auction, sometimes even as late as at the hearing to approve the auction results. When this happens, a court must balance the goal of ensuring the highest price for the assets with the goal of maintaining a fair process that encourages robust bidding and produces final, reliable results for bidding parties.[34] Some courts have placed a greater emphasis on finality,[35] others on obtaining the highest price.[36]

In *Corporate Assets Inc. v. Paloian*, a bidder claimed that it believed it would have a further opportunity to bid, that the bid procedures provided that the sale was not final until the bankruptcy court approved it, and that new information concerning the ability of buyers to store purchased assets on the debtor's premises became available for the first time during the auction itself. In considering the bidder's claims, the Seventh Circuit Court of Appeals held that the bankruptcy court did not abuse its discretion in permitting a second auction after the first auction was "concluded."[37]

In light of the *Paloian* decision, parties conducting auctions should be careful to ensure that their bid procedures are clear about when the auction is declared closed so that parties cannot claim that they had an expectation of a continued ability to bid after the auction.

In light of the *Paloian* decision, parties conducting auctions should be careful to ensure that their bid procedures are clear about when the auction is declared closed so that parties cannot claim that they had an expectation of a continued ability to bid after the auction. Additionally, a court reporter should be present at the auction to ensure that there is an accurate record of what is said at the auction. Finally, the terms of the sale should not be changed at the auction, so as to avoid later claims of an uneven playing field.

The Sale Approval Hearing. After the conclusion of the auction, the next step is the hearing before the bankruptcy court to approve the sale, which is usually scheduled as soon as possible after the auction. At the hearing, the financial advisor offers testimony about how extensively the assets were marketed and describes the manner in which the auction was conducted. The purchaser, through counsel, confirms to the court that it is ready, willing, and able to close the transaction if it is approved by the court. The objective is to convince the court that the sale process was fairly conducted, that the price achieved was the highest or otherwise best achievable, and that the sale to the winning bidder is therefore in the best interests of the creditors of the debtor.

At the sale hearing, parties may object to the sale on various grounds. If there is an objection to the manner in which the sale was conducted, the transcript of the auction will figure prominently in the court's consideration of the objection. Sometimes an objection is on legal grounds. For example, attempts to sell assets "free and clear" of junior liens may be challenged. Debtors frequently rely on Section 363(f)(5) to sell assets free and clear of junior liens on the basis that "such entity [the junior lienholder] could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."[38] Courts are divided as to what this language means. While some courts have held that the debtor must make a specific showing that a mechanism outside of the Section 1129(b)(2) "cramdown" process exists whereby a junior creditor could be compelled to accept less than full payment of its claim,[39] others have held that the existence of the Code's "cramdown" process itself can satisfy Section 363(f)(5).[40] Where a court requires a showing that a mechanism outside of the Code exists that could compel a junior creditor to accept less than full payment of its claim, the existence of judicial and non-judicial foreclosure actions under state law can often satisfy that showing.[41]

The Sale Order. Assuming the sale is approved, the court enters a sale order, the form of which is approved by the purchaser. The sale order always provides that the debtor is authorized to convey the assets to the

[34] See, e.g., Corporate Assets Inc. v. Paloian, 368 F.3d 761 (7th Cir. 2004).

[35] In re Gil-Bern Ind., Inc.526 F.2d 627 (1st Cir. 1975).

[36] *Paloian*, supra note 34.

[37] Id. at 772.

[38] 11 U.S.C. § 363(f)(5).

[39] See Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC), 391 B.R. 25, 45-47 (9th Cir BAP 2008).

[40] See In re Gulf States Steel, Inc. of Ala., 285 B.R. 285. 508 (Bankr.N.D. Ala. 2002); Scherer v. Fed. Nat'l Mortgage Ass'n (In re Terrace Chalet Apts., Ltd.), 159 B.R. 821, 829 (N.D. Ill. 1993).

[41] See In re Jolan, Inc., 403 B.R. 866, 870 (Bankr. W.D. Wash. 2009).

purchaser free and clear of any and all liens, claims, encumbrances, and interests on an "as is, where is" basis. Additional customary terms of the sale order include a finding that the sale process was properly conducted, and that the purchaser acted in good faith which permits the purchaser to receive the benefits of Section 363(m). Section 363(m) provides that a sale to a good-faith purchaser may not be set aside on appeal, even if the purchaser has knowledge of the appeal, and case law supports the concept that in the absence of a stay pending appeal a sale to a good-faith purchaser is final.[42] Sale orders also frequently include a finding that the purchaser is not a successor to the debtor under state or federal law and specify the manner and timing of the distribution of the sale proceeds, including the payment of the breakup fee, the unsecured creditors' carve-out, and a direction that the remaining proceeds are to be paid to the secured lenders. Finally, the sale order will authorize the assumption and assignment of any designated executory leases and contracts being conveyed to the purchaser under Section 365, including a procedure for determining appropriate cure amounts required to be paid under that section.

The Closing. Upon the entry of the sale order, the parties proceed to a closing. Where real estate is involved, a trustee's or quitclaim deed is used to convey title. A real estate title insurance policy will be provided insuring the title free and clear of all liens, claims, and encumbrances (other than easements and other encumbrances which run with the land). Personal property is conveyed by a bill of sale, again reciting that the assets are conveyed free and clear of liens, claims, encumbrances, and interests, and without representations or warranties of any kind. If there is a working capital adjustment, any necessary escrow agreements and related documents would also be executed and delivered. An assignment of executory contracts and leases conveyed pursuant to Section 365 and approved in the sale order is executed and delivered. Other ancillary documents are exchanged and the purchase price, net of any bid deposit which is applied to the purchase price, is delivered by wire transfer. Upon closing, any breakup fee and unsecured creditor carve-out that may be due are paid, and the bid deposit posted by the back-up bidder is returned.

On very rare occasions, the winning bidder fails to close and a closing along the foregoing lines occurs with the back-up bidder. In this event, the debtor will retain the defaulting winning bidder's bid deposit and reserve the right to sue the defaulting winning bidder for other damages as appropriate.

After the closing, the Chapter 11 case is concluded in one of several ways. On occasion, the Chapter 11 is converted to a Chapter 7 proceeding, in which a Chapter 7 trustee administers any unsold assets, objects to claims, and pursues preferences and other avoidance actions. More often, the debtor files and confirms a Chapter 11 plan of liquidation and a liquidating trust is created pursuant to the terms of the plan. The committee designates and often represents the liquidating trustee post-confirmation. The trustee objects to claims as appropriate and pursues other avoidance actions. In rare circumstances where the unsecured creditors are being paid in full (in a single-asset real estate case where there are few creditors, for example), the parties move the court to approve a structured dismissal of the case.

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CONCLUSION

The Bankruptcy Code has been in existence for more than 35 years. For the first two decades of that period, Chapter 11 cases generally proceeded with the objective being confirmation of a plan of reorganization and the retention of the enterprises by the respective owners. However, primarily because businesses became significantly overleveraged, causing secured lenders to hold both large secured and unsecured claims in a case, and because lenders became reluctant to finance very costly Chapter 11 cases without the certainty of success, the objective of most Chapter 11 cases has changed dramatically. Instead of the objective being confirmation of a plan of reorganization, most Chapter 11 cases primarily have become vehicles to sell assets of an enterprise as a going concern quickly and efficiently in a judicially supervised competitive bidding environment, thereby achieving the most proceeds possible for the assets. Whether or not this is what Congress intended, the process described herein is the norm in the vast majority of Chapter 11 cases filed today. ■

[42] See, e.g., Hower v. Molding Sys. Engineering Corp., 445 F.3d 935, 938 (7th Cir. 2006) ("In the absence of a stay pending appeal, the good-faith sale of a debtor's assets is final.").