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ONE'S CRISIS IS ANOTHER'S OPPORTUNITY: SECTION 363 SALES

With the increasing numbers of companies which were once thought to be giants of industry filing for bankruptcy, more opportunities to purchase major assets are becoming available to savvy buyers looking to expand their business or asset base. The Bankruptcy Code provides debtors with the ability to liquidate all or a part of their assets through court-supervised sales and buyers with the ability to obtain those assets at more favorable prices than they would pay if the sale were consummated outside of a bankruptcy.

One of the most advantageous provisions of the Bankruptcy Code is that a deal can be approved and consummated relatively quickly, providing for approval on as little as 40 days notice (or less in exigent circumstances). For example, in the Chrysler case, the sale of substantially all of Chrysler's assets to New CarCo (and Fiat) was approved and closed within approximately 40 days after the bankruptcy filing, while in the Lehman case, the time frame was even more expedited – with entry of an order approving the sale to Barclays only 3 days after the filing of the sale motion.

Basic Procedures for Purchasing Assets From a Debtor

The purchase and sale of assets in a bankruptcy case often begins with a "stalking horse" bidder who has agreed to buy the target assets pursuant to a negotiated asset purchase agreement. The stalking horse bidder is often the bidder who, after some general solicitation of bids outside of bankruptcy, makes the highest bid for the most assets and is the most able to complete the purchase and/or requires the least amount of time, if any, to undertake a due diligence review.

Once an agreement has been reached and finalized with the stalking horse bidder, the debtor will begin the process of seeking bankruptcy court approval of the asset sale. Section 363 of the Bankruptcy Code provides debtors with two options for asset sales: private sales or public auctions. In both private sales and public auctions, a debtor seeking to sell property will be required to provide public notice of the sale and time for parties to object.

In a private sale, the debtor will make a motion to the bankruptcy court for approval of the sale transaction, setting forth the basis for the sale, the terms of the sale, a proposed hearing date for approval of the sale and a deadline by which any objections to the sale must be filed. Although no auction process is contemplated in a private sale, interested parties may submit competing bids for the target assets by "objecting" or otherwise responding to the sale by the objection deadline creating, in essence, in a *de facto* auction for the assets. Typically, however, debtors and bankruptcy courts prefer public auctions to private sales because, among other things, public auctions provide better protection against subsequent claims that the debtor failed to maximize value for the benefit of its creditors.

The sale of Lehman's assets to Barclay's provides a good example of how private sales are utilized in certain circumstances, but are not necessarily favored by the courts. In that case, although the sale was not actually called a private sale, the sale of Lehman's assets to Barclays was undertaken without an auction process being proposed by the debtors or implemented by the court. In approving the sale on an extremely expedited time frame without any competitive bidding procedure, the bankruptcy court noted that the sale had been approved under a unique set of extraordinary circumstances, in an emergency situation, and because it was clear that Barclays was the only interested buyer. Accordingly, the court made clear that the process implemented in that case would not have precedential value.

In a public auction, a debtor will make a motion or motions to the bankruptcy court describing the basis for the sale, the terms of the sale, the procedures for accepting "higher and better" offers and a proposed time and place for the auction of the assets, requiring two separate orders from the bankruptcy court. The first order will be a "procedures order" approving the form of the purchase agreement and the procedures for competing offers and the auction, including break-up fees, bid increments, competitive bid qualification requirements, the auction date and the sale approval hearing date. The second order will be the "sale approval order", which will be entered *after* the auction has been conducted, and will authorize the sale of the assets to the bidder making the "highest and best offer" for the assets. Each order will be subject to separate objection deadlines and hearing dates.

In the context of a public auction, it is generally advantageous to be the stalking horse bidder, as opposed to a subsequent competing bidder. The stalking horse bidder will have some control over the terms of the auction and will negotiate the form of the purchase agreement upon which any future bidders will be required to base their bids. However, competing bidders who are able to work within the terms of the stalking horse's agreement can end up as the successful buyer of the assets at the auction, thereby reaping the rewards of a stalking horse bidder's labors. To offset the risk to the stalking horse bidder that another bidder may win the assets at the auction, and to induce a stalking horse bidder to negotiate and create a competitive market for the debtor's assets despite the potential "loss" of the assets in an auction, the stalking horse bidder's purchase agreement often includes "break-up" fee and/or expense reimbursement provisions, which are intended to cover the stalking horse bidder's costs and, in order to be approved, must be reasonable. In most cases, courts have agreed to approve break-up fees equal to anywhere from 2% to 4% of the overall purchase price, or which are based on the actual, reasonable expenses incurred by the stalking horse bidder.

In some cases, bidding at an auction can be very lively, often taking hours and, in rare cases, days, and increasing the price ultimately paid for the assets by millions of dollars over the original price proposed by the stalking horse bidder. For example, in the case of Riverstone Networks, two bidders emerged – Lucent Technologies and Ericsson. At the auction, held over two days and through numerous rounds of bidding, the purchase price for the assets was increased by $47 million, with Lucent, the stalking horse bidder, ultimately winning the assets with a final bid of $217 million in cash and cash equivalents. In others, there may be no bidding at all, with the auction, if not canceled, lasting no more than 10 minutes so as to create a complete record stating that no competing bidders came forward, and that the stalking horse bidder is the winning bidder. Accordingly, each auction is different depending on the type of assets and the market for the assets – no two are exactly the same.

The Purchase Agreements in the Bankruptcy Context

In addition to providing for a break-up fee and/or expense reimbursement, a purchase agreement in a bankruptcy case differs in certain material respects from a purchase agreement outside of the bankruptcy context. First, a bankruptcy purchase agreement will provide that its effectiveness is conditioned upon the entry of the sale approval order. In addition, the sale of a debtor's assets is usually made on an "as is, where is" basis, with the representations and warranties that a debtor is willing or able to provide being fairly limited and surviving only until closing of the sale. Indemnification by a debtor is rare. The principal reasons for these differences are that: (1) the debtor is generally not an economically viable entity and its representations and warranties are of limited value; (2) the debtor will ultimately be discharged from most of its liabilities as part of the bankruptcy case, including claims under the purchase agreement; and (3) the creditors of the debtor desire finality and do not wish to have ongoing exposure that may diminish the assets of the debtor available for distribution.

A potential buyer of assets should not, however, let these differences and limitations deter it. The fact is that a properly drafted sale order will provide a buyer of distressed assets with essentially the same or better protection as a buyer outside of bankruptcy, by providing that the assets are being sold free and clear of any liens, claims, encumbrances or other interests therein (resulting in what is referred to as a "cleansing" of the assets) and that the buyer is a "good faith" purchaser. This language alone generally protects a buyer from, and is generally enforceable against, any claims of a third party or the debtor in or to the assets and releases any liens or other encumbrances on the assets, with such liens, claims, interests or other encumbrances attaching to the proceeds from the sale of that asset.

Closing Thoughts

Each sale of assets by a debtor in bankruptcy is unique. The fundamental principle in all sales is that the sale be conducted in a manner that is reasonably calculated to maximize value for the debtor's creditors and estate, and that each sale be negotiated and conducted on an arms' length basis in "good faith" by the debtor and purchaser. These general rules apply equally to all bidders providing all potential buyers with the same protections, but also submitting all buyers to the jurisdiction of the bankruptcy court.

In addition, the scope of the assets that can be sold through these section 363 sales is extremely broad – the assets can be in the U.S. or outside the U.S., and they can be tangible assets like inventory, equipment, real property, fixtures etc. and they can also include intangibles such as stock, leases, mortgages, loan portfolios and intellectual property. Consequently, they can be an effective tool to expanding a company's business and, in many cases, represent tremendous opportunities to a savvy purchaser.

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