

Section 363 Sales In Bankruptcy

Trends and Opportunities From a Practitioner's
Perspective

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Bankruptcy Background

- Traditionally
 - Bankruptcy cases were initiated to reorganize
- The modern trend
 - It is all about sales
- Traditionally
 - The sale of assets was a strategy in bankruptcy
- The modern trend
 - Bankruptcy is the strategy for the sale of assets

Why Are Bankruptcy Sales So Trendy?

- Asset sales are free and clear of all liens, claims and encumbrances
- Any liens or claims attach to the proceeds of the sale
 - i.e. stay with the seller
- Buyer can get clean title and protection with an order from the Bankruptcy Court
- Sellers can utilize the automatic stay while running the sale process

Trendy But Not Cheap

- Bankruptcy sales are trendy and have advantages, but . . .
 - NOT CHEAP
- Can be more cumbersome and bring additional constraints (court imposed rules), new parties to the table (committees) and make it easier for your adversaries to object

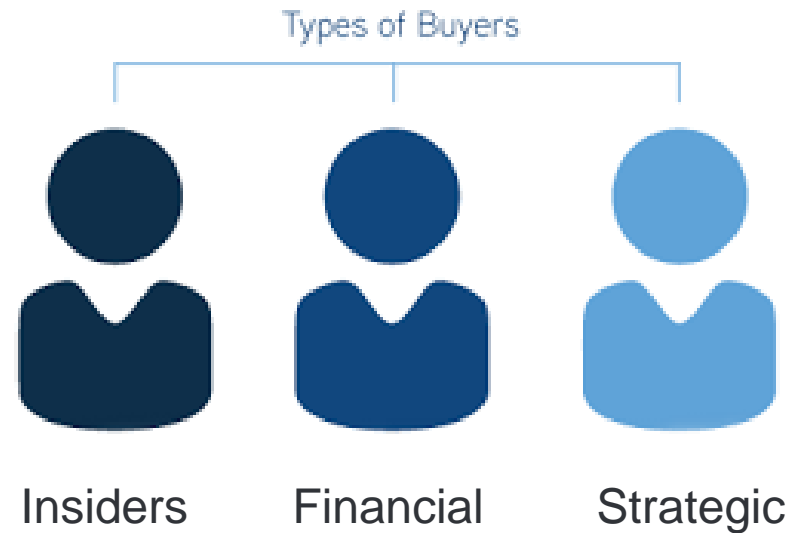


Section 363 of the Bankruptcy Code

- Trustee/DIP may use, sell, or lease property of the estate in ordinary course of business
- OCB Sales (i.e. inventory)
 - No notice or hearing required
 - Operations continue without disruption in bankruptcy

Types of Buyers

- Insiders, existing investors or existing creditors that know the business from the inside
- Financial Investors
- Strategic Buyers



How to Sell? “Business Judgement” Test

- Terms of Sales are at Debtor’s discretion “Business Judgment”
 - Subject to court approval
- Method of sale – part of the Debtor’s discretion
 - Private sales
 - Public auctions
 - Auction sales with formal bid procedures

Auction Sales in Bankruptcy

- Auctions are not required, but it is helpful to provide:
 - Exposure of property
 - Notice
 - Proof of highest and best offer
 - Proof of good faith/arm's length dealing



“Business Judgement” – Method of Sale

- To determine the best method of sale – no hard and fast rule
- “I know it when I see it.”



Method of Sale – You be the Judge

- You be the Judge:
 - De Minimis Assets
 - FF&E
 - 1 Vehicle vs. 40 Vehicles
 - Real Estate
 - All or substantially all business assets of a \$50M company
 - Others ??



Method of Sale – Now, the Judge is the Judge

- Courts look for a sound business reason to justify the sale and the sale methodology
- Court may also consider
 - Best interests of estate
 - Adequate price
 - Proper notice
 - Good faith
 - Arm's length negotiation



Private Sales and Public Auctions

- Private Sales

- Still need court approval
- Can be truncated notice with omnibus procedures
- Still subject to higher and better offers
- How much notice is needed?
- Higher scrutiny for insider deals

- Public Auctions

- Debtor may hire auctioneer with court approval
- Need to advertise and market



Private Sale with Formal Bid Procedures

- Sale of all or substantially all assets
- Can be done in a Chapter 7 or 11
- This is where the action is —
 - Where regular M&A and bankruptcy intersect



Bid Procedures

- Auctions use court-approved bid procedures
 - Very detailed
 - Qualified Bidders
 - Helps to satisfy business judgment
 - Tests market for assets
 - Demonstrates bidder's ability to consummate sale
 - Allows others to compete on an even playing field

Stalking Horse Bidder

- The Debtor finds a prospective buyer to make initial bid through an executed purchase agreement
- “Stalking horse bidder” holds initial bid through auction process
- Bid may contain bid protections
 - Must benefit the estate
 - Must be court approved

Reasons for Bid Protections

- Entice offer by initial bidder
- Entice initial bidder to become stalking horse
- Promote more competitive bidding
- Compensate stalking horse if its bid is topped

Types of Bid Protections

- Breakup fee (typically 3%)
- Topping fee
- Expense reimbursement
- Minimum overbids
- Deadlines for due diligence or bids by competing bidders
- Deadline for approval of initial bid

Bid Procedures

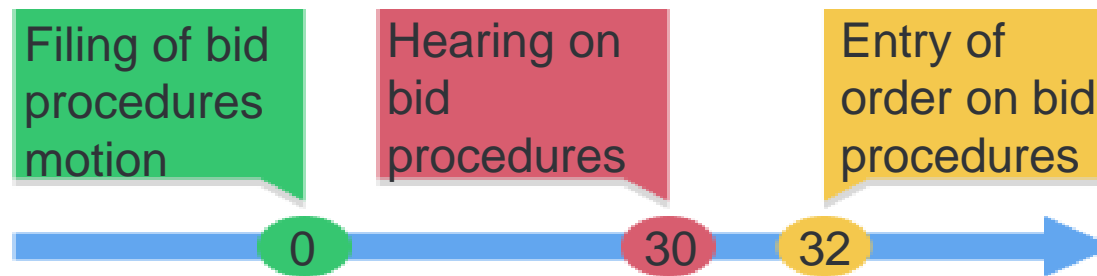
- Motion to approve bid procedures
 - Must show procedures will promote bidding or improve sale price
- Court enters order approving procedures
 - All parties are noticed
 - Investment bankers shop the bid

Order Approving Bid Procedures

- Hearing dates and deadlines
 - Objections to Bid Procedures
 - Bid Deadline
 - Auction Date
 - Sale Objection Deadline
 - Sale Hearing
- Process for assumption and assignment of contracts

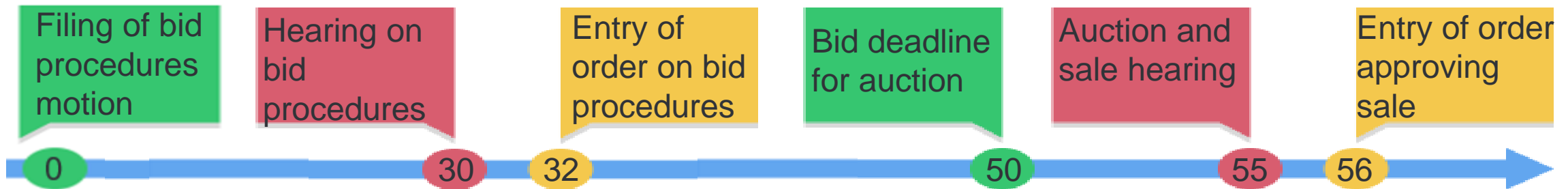
Typical Timeline for Auction

- Can be shortened and expedited
- Before auction (before bankruptcy case usually) – initial bid obtained and executed
- Day 0 – filing of bid procedures motion
- Day 30 – hearing on bid procedures
- Day 32 – entry of order on bid procedures; filing of sale motion (if needed)



Typical Timeline for Auction

- Day 50 – bid deadline for auction
- Day 55 – auction and sale hearing
- Day 56 – entry of order approving sale



- Thereafter, closing
 - 14-day stay typically waived

Marketing Methods – Informal

- Notice of sale on docket
- Publication of notice of sale
- Advertising
- Solicitation and/or direct marketing



Marketing Methods – Formal

- Brokers – Commissions
- Investment Bankers – Transaction Fees
- Credibility and Marketing Expertise
 - Strategic
 - Financial
- Expert Testimony



Competing Bids

- Parties potentially interested in competing sign a Nondisclosure Agreement and are given access to data room to conduct due diligence
- Competing bidders submit bids in accordance with bid procedures



Auction

- If no competing bids – no auction will occur
- Obtain court approval of stalking horse bid
 - “See, Judge, I tried”
 - Not an unusual result
- If there are other bids – auction held
 - Other bids must be “qualified”
 - Meet standards in bid procedures as interpreted by the Debtor and its investment bankers with consultation from the committee and lenders

Qualified Bids

- Sufficient qualifying identifying information
- Written Asset Purchase Agreement with blackline to stalking horse
- Identifies all assets and executory contracts to be purchased
- Irrevocable
- No contingencies
 - Not for due diligence or financing

Qualified Bids

- Sufficient Overbid
- Good Faith Deposit (10%)
- Financial wherewithal
 - Purchasing entity
 - Guaranty from principal
- Materially close to stalking horse bid
 - Comparing apples to apples

Auction – Logistics

- Auction could be held in court
 - Traditionally they were
- Now, generally held in law offices or other venues
- Debtors and investment bankers try to “normalize” all bids
- Qualified bidders may increase bids at auction
- Debtor and its advisors select the “highest and best” offer as the winning bid

Sale Order

- After auction, the Debtor will proceed with court approval of the “highest and best” offer
 - May occur immediately after in-court auction
- Court enters order approving sale



Winning Bids

- After court approves sale, winning bid must close sale or lose deposit
- If sale does not close, Debtor may complete sale with next highest bidder without hearing
- Back up bidder/second highest remains obligated until sale closes with the first bidder

Grounds for Objection to Sale

- Landlord objections
- Objection to buyer's ability to perform in future
- Lack of sound business judgment
- Secured creditor objections
- Irregularities in bidding
- Property ownership dispute

Contracts and Leases

- Generally
- Valuation and enhancement of sale value
- Assumption and Assignment as separate concepts



Assignment and Assumption of Contracts and Leases

- Must cure defaulted contracts or provide adequate assurance of cure
- Must provide adequate assurance of future performance by assignee
- Court approves decision to assume/assign
- Typically a buyer pays for all cure costs

Certain Contracts Cannot Be Assigned

- Personal services contracts
- Debt or financial accommodations contracts



Special Rules for Nonresidential Real Estate Leases

- Requirement to pay rent until assumed and assigned
- Requirement to assume or assign within 120 days
- Special rules for shopping centers.



Role of Professionals in Sale Process

- General Counsel
- Investment Banker
- Financial Advisor
- Other Professionals

Questions?

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