The Dealmaker's Guide to Buying Distressed Assets
Section 363 Sales and the Alternatives

I. INTRODUCTION

This article is for the deal professional seeking an introduction to purchasing distressed enterprises (or pieces thereof) under Bankruptcy Code § 363. While acquisitions of distressed companies can be effected through a number of different means, both inside and outside of bankruptcy, [FN1] this article focuses on acquisitions pursuant to Bankruptcy Code § 363. In Part II, we review key advantages of purchases inside bankruptcy and contrast them with nonbankruptcy alternatives. In Part III, we discuss how bankruptcy and nonbankruptcy alternatives are weighed by interested parties. Section 363 sales are discussed in depth in Part IV, and our concluding thoughts are offered in Part V. Throughout this article we seek not only to paint the legal landscape but to also discuss the competing considerations in which business decisions in this context are made in the real world.

II. KEY ADVANTAGES OF PURCHASING ASSETS THROUGH BANKRUPTCY

Sales of businesses inside of bankruptcy (whether pursuant to section 363 or a confirmed Plan), have been favored by debtors (as sellers) and buyers historically for a variety of reasons, most importantly the following:

A. Asset Sales in Bankruptcy Generally Are Free and Clear of Liens and Claims

Perhaps the most significant benefit provided by a bankruptcy court order approving a 363 Sale or sale under a Plan is that the debtors' assets are transferred to the purchaser free and clear of virtually all liens and claims, subject to certain exceptions discussed below.

B. Purchasers May "Cherry Pick" Contracts

Bankruptcy Code § 365 allows a debtor to assume most [FN2] contracts (including leases) even if the debtor breached those contracts before bankruptcy, so long as all defaults are cured and the purchaser can provide "adequate assurance of future performance" under the contracts at issue. [FN3] Generally, a purchaser will meet this test if it is in the same or better financial condition as the debtor was at the time that the debtor executed the contract. Alternatively, a purchaser may leave behind those contracts and leases that are not desired. Prospective buyers can thus, to a great extent, buy a debtor's business free of the obligations that had historically hindered the debtor's business or that are (for strategic buyers) redundant assets. [FN4]

C. Ability to Bind Nonconsenting Shareholders

Debtors, in many instances, are unable to obtain the necessary backing of their shareholders. Outside of bankruptcy, many corporate charters require majority shareholder approval before substantially all the assets of a company may be sold.

Bankruptcy overrides such provisions and therefore can overcome significant shareholder resistance to a sale. Bankruptcy thus makes some transactions possible when companies might otherwise be penalized by a lack of shareholder consensus.

A sale pursuant to Bankruptcy Code § 363 has the added advantage of speed as compared to an acquisition pursuant to a confirmed Plan. Unless the Plan is proposed and approved prior to any bankruptcy filing (a so-called Prepackaged Plan), the timeline for such an acquisition can be slow because it must be confirmed by various classes of creditors. Section 363 sales, by contrast, do not require consent of all creditors but only of the bankruptcy court where the relevant bankruptcy case is filed. [FN5] Prospective buyers thus can pursue a quick transaction and ensure as best as possible that goodwill, key employees, and other assets of the enterprise are preserved.

D. Protection for the Seller's Management and Directors

Because a sale of substantially all of the assets of a company in bankruptcy must be noticed according to the Federal Rules of Bankruptcy Procedure and approved by a bankruptcy court under Bankruptcy Code § 363 as a sound exercise of the debtor's business judgment, proceeding with a sale in bankruptcy offers a substantial degree of protection to a debtor's management and directors from lawsuits by unhappy or litigious shareholders or creditors.

E. Limited Representations and Warranties

A seller/debtor also has the benefit that he or she will be able to limit the representations and warranties regarding assets sold in bankruptcy because a purchaser

will generally be taking assets free and clear of liens, claims, and encumbrances under Bankruptcy Code § 363.

Nonetheless, for reasons discussed below, debtors must consider whether a sale inside of bankruptcy will maximize the value of the estate (and thus must consider the interests of potential bidders and weigh transaction costs against relative value offered by alternative transaction arrangements).

Out-of-court restructurings are becoming increasingly common in today's environment because secured lenders are often inclined to support a debtor's decision to put its business into receivership or pursue an assignment for the benefit of creditors because they perceive such transactions as less costly and less public--resulting in less likelihood of their security interests being attacked by unsecured creditors. For example, out-of-court restructurings offer the following benefits:

(1) Flying Under the Radar. Transactions are less scrutinized and public than inside of bankruptcy. As a result, a purchaser may avoid challenges from potential competitive bidders.
(2) Nonbankruptcy Transaction Is Quicker. A nonbankruptcy transaction likely can be accomplished more quickly and economically. This is due, in part, to the absence of any requirement that a prospective purchaser obtain the consent of statutory creditor or equity security holder committees, the U.S. Trustee, or abide by any notice periods provided by the Federal Rules of Bankruptcy Procedure to allow interested parties adequate time to respond or object to proposed sales. [FN6]
(3) No Negative Effects of Bankruptcy Filing. A transaction outside of bankruptcy avoids the negative effects of a bankruptcy filing on a debtor's business operations, such as a reflexive tightening of credit terms from vendors, loss of confidence and loyalty from employees, and the perception of a "tarnished brand" by the public consumer.

Nonetheless, out-of-court purchases lack many of the advantages of purchases inside of bankruptcy and thus have the following downsides:

A. No Ability to Bind Nonconsenting Creditors. Outside of bankruptcy, a company may be unable to bind nonconsenting shareholders who do not consent to the terms of the purchase. [FN7]
B. Inadequacy of Debtor's Agreements Cannot Be Remedied. Where the debtor already has defaulted on agreements, and cure periods have expired, even a purchaser's willingness to perform under the terms of the debtor's original agreements may be insufficient. Creditors, in that instance, may have accelerated debt or taken other action. No forced deceleration or forced modification of agreement terms is available outside of bankruptcy. [FN8] In bankruptcy, not only can contract defaults be "cured" but even contracts which by their terms are "non-assignable" may be assigned. [FN9]
C. Bulk Sales Act, De Facto Merger, and Successor Liability. As discussed below, there is risk--under the de facto merger doctrine, the mere continuity doctrine, or substantial continuity doctrine, the successor liability doctrine, and similar doc trines [FN10]--that, where a purchaser acquires substantially all of an insolvent debtor's assets outside of bankruptcy, the purchaser will inherit involuntarily some or all of the debtor's liabilities if the debtor does not pay them. In nondistressed situations, successor liability concerns are less significant because sellers will ordinarily obtain commitments from their lenders to release security interests in assets sold and will ordinarily receive sufficient proceeds to payoff remaining liabilities (or have buyers assume existing liabilities). Sales of distressed businesses, by their very nature, on the other hand, usually result in certain debts outstanding, and the creditors with respect to those debts may seek recourse. As a result, the imprimatur of a court-approved sale can be valuable to dissuade creditors from seeking recourse against a buyer.

III. WEIGHING THE OPTIONS: PERSPECTIVES OF INTERESTED PARTIES

A threshold decision is whether the purchase will involve a bankruptcy filing by the seller. In the first instance, this decision belongs to the seller. The decision, however, is driven by a number of other players, in addition to the seller, based on several basic considerations.

A. Buyers Versus Secured Lenders--The Basic Tension

Buyers desire certainty of closing and the cleansing of title offered by a sale of assets under section 363. These two paramount desires do not necessarily operate in tandem. Bankruptcy courts expect a thorough marketing of assets sold under section 363 and, except in extraordinary circumstances, an auction. Thus would-be buyers must forsake some control of the acquisition process, ceding such control to the bankruptcy court and an auction process in order to reap the other advantages offered by an acquisition under section 363.

Secured lenders, on the other hand, are more likely concerned with liquidating collateral--which could be the sale of a debtor's business as a going concern--as quickly as possible, with the least administrative costs (i.e., legal fees, procedural hassles, etc.) and for the highest value.

While a secured lender will not dictate a seller's chosen course, the looming threat of foreclosure proceedings or its objection to any sale under section 363, and the fiduciary considerations of the seller's directors and officers, provide secured lenders a prominent place at the bargaining table. Potential buyers need be mindful, as a result, that they are in essence bargaining with at least two parties--both the seller and the secured lender--and never merely with the residual equity holders of a distressed target company. Indeed, as discussed below, some courts have concluded that the fiduciary duties of directors of distressed companies apply to creditors

when such companies become increasingly distressed.

These expanding fiduciary duties are contrasted to the duties of directors of a solvent company, who have fiduciary duties only to shareholders. Consistent with their overriding desire to keep costs down and maximize value of collateral, secured lenders may push back on a buyer's desire to realize value through the special advantages attendant with an acquisition pursuant to section 363. [FN11]

B. The Debtor's Concern: Fiduciary Duties of Directors, Officers, and Management

Directors and Officers (DOs) of an insolvent (and, potentially, nearly insolvent [FN12]) company have fiduciary duties not only to shareholders but to all creditors. [FN13] In fact, some courts have concluded that the less solvent a corporation becomes, the more these duties shift entirely to creditors. [FN14] Accordingly, DOs' goals cannot be limited to maximizing shareholder value; DOs must seek to obtain the greatest return for all creditors. [FN15] Thus while lenders may not actively negotiate a transaction, the law operates to force directors and officers to consider their interests. The management of a debtor in bankruptcy also has a fiduciary duty imposed under bankruptcy law to obtain the highest and best price on any sale of assets. [FN16]

Outside of bankruptcy, DOs have a duty to conduct a public auction whenever a corporation's actions make the sale of the business or dissolution of the corporate entity inevitable. Privately negotiated sales generally are also disfavored in the bankruptcy context. [FN17] The initial bidder enjoys certain advantages in an auction inside of bankruptcy, however. At a bankruptcy auction courts commonly approve a variety of bidding protections to ensure that competitive bidders are not "free riders" on the initial bidder's (i.e., the stalking horse's) due diligence and valuation of the debtor's business.

C. The Bottom Line--A Public Transaction

Numerous constituencies must be dealt with when purchasing the assets of a distressed entity inside a bankruptcy. Such a purchase is not simply a two-party transaction between a seller and buyer. A potential purchaser may have to negotiate with, or address the concerns of, a variety of stakeholders such as: trade creditors, bondholders, shareholders, lessors, secured creditors, employees, governmental entities, the U.S. Trustee, and, ultimately, the bankruptcy court.

Section 363 Sales necessarily require court filings describing the financial and market position of the debtor, past or current marketing efforts, the basic terms of a stalking horse's bid and the merits of such bid, the transaction time line, executory contracts to be assumed or rejected, and the names of creditors of the debtor target company. The Trustee or the Committee will closely scrutinize the transaction with a critical eye towards process and challenge director actions deemed contrary to a board's fiduciary duties.

As a result of DOs' broadened fiduciary duties, prospective buyers cannot merely appeal to the interest of equityholders (or even secured lenders). Each distressed situation is different, and the driving constituencies will vary from case to case. [FN18] In every case, however, a marginally better purchase price will not by itself lead to a winning bidding strategy. Debtors considering a sale of assets comprising its business must weigh the value created for prospective buyers purchasing assets out of Chapter 11--and the real purchase price premiums potentially available--against the risk that any purchase price premium will be undone by transaction costs.

Not surprisingly, notwithstanding the many potential advantages offered by sales within bankruptcy, lenders and prospective buyers are increasingly seeking out-of-court transactions that are less transparent to such other stakeholders in the hope that a less public transaction will attract less interest (i.e., from other buyers) or scrutiny (i.e., other team creditors). Interested buyers approaching a distressed business weighing its options can exert great influence on this decision.

IV. 363 SALES

A. When Is a 363 Sale Allowed?

The Bankruptcy Code neither expressly authorizes nor prohibits a debtor from selling all or substantially all of its assets pursuant to a 363 Sale. The right to do so is sometimes contested on the basis that such a sale short-circuits the more elaborate safeguards of the Plan confirmation process, in particular the duty to provide adequate information to parties in interest.

The majority of recent cases hold that a sale of substantially all the assets of a debtor can be approved without a Plan, provided that the sale proponent demonstrates a good, sound business justification for conducting a sale prior to confirmation. [FN19]

B. Bankruptcy Court Approval of a 363 Sale Generally Takes Place in Two Stages

The 363 Sale process is extremely flexible and can take many forms. The most common scenario is for a sale to occur in two stages. The first stage entails the debtor obtaining bankruptcy court authority to proceed with a sale to a stalking horse, subject to higher and better offers at an auction, as well as the approval of procedures to follow leading up to and at the auction. The second stage consists of the auction itself, as well as a hearing to approve the results of the auction. Often, the auction and the hearing to approve the results of the auction occur on the same day or within a few days.

1. First Stage

Again, the first stage entails the debtor obtaining bankruptcy court approval of the auction procedures, including certain protections for the stalking horse, and authority to proceed with the auction. These procedures are proposed in a motion filed with the bankruptcy court. This motion can be heard on an expedited basis (a matter of days from its submission). Examples of the bidding protection procedures sought by potential purchasers include solicitation procedures, auction procedures, and DIP financing.

Solicitation Procedures

The establishment of procedures that limit the debtor's solicitation of competing bids, such as:

•Prohibiting the debtor from directly or indirectly soliciting further offers for the assets (i.e., a "no shop" clause)
•Requiring potential competing bidders to submit competing bids a minimum number of days in advance of the auction (and requiring the debtor to share those bids with the proposed purchaser)
•Requiring the terms and conditions of competing bids to be the same as, or substantially similar to, those contained in the stalking horse's purchase agreement

Auction Procedures

The establishment of auction procedures that could include:

•A provision that there will be no auction unless qualified competing bids are submitted before a particular deadline
•All bids be in minimum incremental amounts
•A requirement that the initial topping bid exceed the stalking horse bid by a certain percentage or dollar amount
•Allowing the stalking horse the right to match any qualifying bid
•Full or partial expense reimbursement or a breakup or topping fee to the stalking horse in the event that some other party is the successful purchaser or if the sale does not occur to the stalking horse for some reason other than the fault of the stalking horse. The breakup fee can take the form of a percentage of the increased amount of the bidding or a set fee [FN20]
•A provision requiring bids to be judged on the basis of which bid provides the most net cash to the debtor. In the event a break-up fee, topping fee, or expense reimbursement is promised to a proposed purchaser, the bid then would be judged on the basis of the highest net dollars to the estate rather than the gross amount of the bid, thereby requiring a competing bidder to bid more to provide the same net return to the estate.

DIP Financing

In a broad sense, another strategic "bid protection" device that may be employed by a stalking horse bidder is debtor-in-possession financing. To the extent that the debtor is in sufficiently dire need of such financing and the stalking horse bidder is the only available financing source, the purchaser can link the financing to the approval of satisfactory bid terms and auction procedures. Also, the loan may provide for acceleration of its maturity date if an offer is accepted from another party, with an immediate acceleration if the debtor actively solicits another bid. Provisions in the loan agreement may also be included which are aimed at positioning the debtor operationally in a manner that the proposed purchaser wishes.

If the bidder is not providing the DIP financing, it should nonetheless condition its obligation to close any transaction on the lack of a material adverse effect or compliance with certain operational covenants (predicated on the debtor receiving the continued financing necessary to operate its business) in order to ensure the debtor's business has not deteriorated between signing and a close following an auction process. If the debtor fails to meet such conditions, the buyer will have a right to terminate or renegotiate the purchase price to reflect the enterprise's diminished value.

2. Second Stage

The second stage is the auction itself and the hearing to confirm the result of the auction. Often, the hearing and the auction occur on the same day or shortly thereafter.

3. Judicial Involvement

There is no specific prohibition against a bankruptcy court conducting, or being present for, an auction. However, many bankruptcy judges believe that they should not be involved in auctions, instead allowing the debtor to conduct the auction outside the presence of the judge. These judges believe that they should limit their involvement in the case to ruling on legal disputes, as opposed to becoming involved in the actual administration or operation of the debtors' estate. These judges also often take the position that the debtor has discretion in the reasonable exercise of its business judgment to set auction procedures, and even to modify them during the auction process, in order to obtain the highest and best recovery for the debtor. On the other hand, some judges do get involved, and many will actually hold the auction in the courtroom. [FN21] There is simply a great deal of discretion in this area.

4. Variations on the Two-Stage Procedure

•No First Stage: In some 363 Sales, no first-stage court hearing ever occurs, i.e., no bidding, auction, or expense reimbursement procedures are established until the auction occurs immediately prior to the hearing to approve the sale. In this case, the proposed purchaser may have little procedural protection.
•No Stalking Horse: Occasionally a debtor will proceed straight to an auction without first receiving any committed bids (sometimes called a "naked auction"). In such circumstances, purchasers are often expected to accept a form contract if they are the winning bidder.

Alternatively, a debtor may solicit sealed bids for its assets and then negotiate a contract with the winning bidder.
•Bid Procedures with No Stalking Horse: Bid procedures are sometimes approved with no stalking horse, with the bankruptcy court authorizing the debtor to award bid protections to whoever becomes the stalking horse.

5. Standards for Approving the 363 Sale

The standard that bankruptcy courts generally apply is whether a sound business reason supports the sale, [FN22] together with whether interested parties were provided with adequate and reasonable notice, the sale price is fair and reasonable, [FN23] and the purchaser is acting in good faith. [FN24]

A purchaser should obtain a finding from the bankruptcy court that it is a good faith purchaser under Bankruptcy Code § 363(m). As discussed in greater detail below, section 363(m) provides that a purchaser or lessee of property of the estate is protected from the effects of a reversal on appeal of the authorization to sell or lease so long as the purchaser acted in good faith and the appellant failed to obtain a stay of the sale.

C. Activities that Take Place Between the First and Second Stage

1. Purchase Agreement Completed

If not already finalized, the proposed purchaser and debtor should complete negotiation of a definitive purchase agreement. A purchase agreement in the 363 Sale context differs markedly from the nonbankruptcy purchase agreement.

•Because the debtor typically is insolvent, the purchaser cannot expect to derive any significant protection by means of debtor's representations, warranties, and indemnification.
•Hold-backs and escrows typically are more difficult to negotiate because creditors generally demand a known net purchase price.
•Absent bankruptcy court approval, a debtor will not be bound by any agreement executed outside the ordinary course of business, including a 363 Sale purchase agreement. However, absent an express provision to the contrary, the proposed purchaser may, in fact, be bound at the time of execution. Therefore, effectiveness of the purchase agreement should be conditioned on the entry of an order approving the sale which is satisfactory to the proposed purchaser.
•The agreement should include deadlines for the debtor's presentation of motions to approve the bid and auction procedures and for approval of the sale itself, as well as deadlines for the entry of orders approving these motions.
•Provisions concerning the location of litigation relating to the purchase generally will not be effective to prevent the bankruptcy court from continuing to exercise jurisdiction over many aspects of the transaction.
•Provisions concerning expense reimbursement or break-up fees must be drafted to address priority of claim issues, e.g., whether payment of the proposed purchaser's expense reimbursement or break-up fee will "prime" the senior secured lender. The proposed purchaser will want comfort that any bidder protection will be paid even if there are adverse developments in the bankruptcy case.
•The purchase agreement should contain a method for the debtor's assumption and assignment to purchaser of contracts in order to ensure that all defaults are cured. Responsibility for payment of the cure costs should be clearly delineated.
• The purchase agreement should contain termination provisions that allow a purchaser to walk away from the sale if certain adverse bankruptcy events occur, such as the appointment of a Chapter 11 trustee, conversion of the case to Chapter 7, or the loss of debtor-in-possession financing or use of cash collateral necessary to preserve the value of purchased assets during a transition period or prior to the sale closing.

2. Due Diligence

Depending on the gravity of the debtor's financial situation, the debtor might seek an accelerated auction process, and due diligence may also be accelerated. Prospective buyers should assume that debtors will be less proactive with regard to due diligence matters and generally less responsive as a result of its financial situation and stretched resources. Prospective buyers may or may not benefit from this due diligence environment. Debtors may exercise less discretion and push back less with regard to a prospective buyer's inquiries. Proactive buyers, in short, stand to gain from this situation. Because purchase agreements in 363 Sales rarely provide for postclosing indemnification it is especially important for prospective buyers to ferret out as many skeletons and address as many postclosing operational issues as possible before any transaction is consummated.

3. Financing

The proposed purchaser, of course, must obtain the financing necessary for the transaction.

4. Consents and Other Regulatory Filings

As discussed below, necessary approvals of equity holders of a debtor selling substantially all of its assets are overridden by the Bankruptcy Code. Third-party consents with respect to contracts that are typically nonassignable are not required. Nonetheless, contractual and regulatory limits are not completely overridden by a bankruptcy court's approval of a 363 Sale.

Antitrust

Any necessary regulatory approval must be obtained, including Hart-Scott-Rodino (the HSR Act) antitrust clearance. The HSR Act requires that the seller must notify the Department of Justice (Antitrust Division) and the Federal Trade Commission of the proposed transaction and wait 30 days. Bankruptcy Code § 363(b)(2) shortens this review period to 15 days. [FN25]

Other Regulatory Filings

Bankruptcy does not in all instances obviate the need to receive necessary consents from various governmental industry regulators. For instance, sales of broadcast licenses are subject to the approval of the Federal Communications Commission. [FN26]

Other Required Consents

As discussed above, restrictions on assignment in agreements between the debtor and third parties generally are not enforceable in the context of the assignment of contracts pursuant to Bankruptcy Code § 365. However, this is not universally true. Certain contracts--such as personal services contracts or nonexclusive licenses--generally cannot be assigned absent a third-party consent. [FN27] A purchaser desiring of the benefits that they confer on its target must obtain a consent from third parties with respect to such agreements.

D. Summary of a 363 Sale Timing

One of the virtues of a 363 Sale is that it can be accomplished with relative speed. While the process is, as described above, often two-stepped, many of the tasks may be pursued at the same time. A "stage one" motion can be submitted on a term sheet or even a letter of intent, and while the auction cannot usually take place for 20 days or more, the purchaser can complete due diligence, secure financing, and finalize negotiation and drafting of a definitive purchase agreement with the debtor before the auction.

E. Competing Bidders Generally Have No Standing to Dispute Auction Procedures

A bankruptcy court's ordinary focus with respect to auction procedures is on whether they are likely to produce the best return to the debtor. It is unlikely that a bankruptcy court would overturn procedures supported by the debtor and major creditors solely because competitive bidders feel aggrieved by the auction process. Competing bidders generally do not even have standing before the bankruptcy court to challenge a 363 Sale. [FN28] The rationale is that disappointed bidders are strangers to the proceedings. Nevertheless, despite the black letter law on the issue, many bankruptcy courts will at least hear aggrieved bidders.

This lack of standing for "disappointed bidders" should be contrasted to bidders that seek to challenge the fairness of a sale process. Numerous courts have granted standing to bidders that seek to challenge the conduct at an auction or the fairness of a sale process. [FN29]

F. A Purchaser in a 363 Sale Takes the Assets Free and Clear of Liens and Claims

A key benefit of purchasing assets in a 363 Sale is that a purchaser takes the assets free and clear of liens and encumbrances. Bankruptcy Code § 363(f) provides that assets may be sold free and clear of the liens, claims, encumbrances, and interests of third-parties if one of the following five conditions is met:

(1) nonbankruptcy law permits a sale of the assets free and clear of such interest;
(2) the interest holder consents;
(3) the interest is a lien and the price for the assets is greater than the aggregate value of all liens on such property;
(4) the interest is in a bona-fide dispute; or
(5) the holder of the interest could be compelled to accept a money satisfaction in a legal or equitable proceeding.

G. Limitations on Avoidance of Liabilities

A general rule, even outside of bankruptcy, is that when a corporation or other legal entity sells assets (even substantially all of its assets) to a third party purchaser, that purchaser is not liable for the liabilities of the seller. [FN30] However, as discussed further above, there are numerous exceptions to this general rule which pose significant risks for would-be purchasers. [FN31]

Bankruptcy provides an added level of protection not otherwise available for all but a handful of risks because bankruptcy courts generally protect purchasers from successor liability and related doctrines. Some dispute exists, however, as to whether even a bankruptcy court can effectively order the transfer of assets free of certain liabilities. [FN32] Examples include:

1. Product Liability

A product sold by the debtor before the purchase causes an injury after the purchaser buys the debtor's assets, [FN33] or a person who was exposed to a debtor's asbestos products before the purchase and manifests disease after the purchase.

2. Environmental

An oil leak that occurred before the purchase results in a cleanup order after the purchase. [FN34]

3. Employee-Related Claims

Courts may permit assets to be sold free of such liabilities. However, as with the above situations, these matters are highly fact-specific and subject to varying judicial views. [FN35]

Thus even in bankruptcy, there are, as described above, some risks that a purchaser simply cannot avoid or completely

avoid by virtue of a court order alone. Therefore, potential purchasers are well-advised to consider engaging in extensive due diligence, requiring debtors to provide extensive notice of the proposed sale, avoiding conduct on its own part that could support application of the de facto merger, substantial continuity, or similar doctrine as described above, negotiating for ratification of the transaction in any Chapter 11 plan, and negotiating for an escrow of a portion of the sale price to support any indemnification claim the purchaser may need to bring against the debtor, and insisting on certain provisions in the order approving the sale which further buttress the purchaser's position.

H. Bulk Sales Act Inapplicable

The Bulk Sales Act does not apply to a 363 Sale. [FN36]

I. Transfer Taxes Avoided?

Bankruptcy Code § 1146(c) provides that such transfer taxes do not apply to a Plan confirmed under section 1129, and there has been some success in arguing that this provision applies with equal vigor to 363 Sales. [FN37]

J. Stock Purchase

Ordinarily, a 363 Sale purchaser will not purchase the stock of a debtor for the following reasons:

•The purchase of stock would subject the purchaser to all the liabilities of the debtor.
•If a purchase of stock is necessary to take advantage of a tax benefit or for some other reason, it is likely the purchase would occur through a Plan. As described below, a Plan allows for more flexible structuring alternatives than does a 363 Sale.
•If the debtor is a holding company with various subsidiaries that are not in bankruptcy proceedings themselves, it is more likely that the debtor's stock in a subsidiary will be the subject of a 363 Sale.

K. Collusive Bidding Prohibited

Parties can enter into a joint venture to purchase assets out of bankruptcy. Although pooling of resources for bidding purposes is often a legitimate business tool, purchasers must be particularly careful in the bankruptcy context to avoid being accused of collusive bidding, i.e., "controlling the sale price by an agreement among potential bidders." Bankruptcy Code § 363(n) allows for compensatory and even punitive damages if collusive bidding is found. [FN38] To avoid collusive bidding liability, early disclosure of joint bidding intentions before formally entering the bidding process is sometimes advisable.

L. The Sale Approval Order

It is common for purchasers' counsel to draft sale approval orders. Specific findings aimed at preventing later arguments by would-be plaintiffs can be effective, as can the inclusion of an injunction against such suits.

M. Finality

It is very difficult for any objecting party to overturn on appeal an order approving a 363 Sale. Under the Bankruptcy Code, the beneficiary of an order generally cannot act upon that order for 10 days. A purchaser may however close a transaction immediately upon the entry of an order approving a 363 Sale. Additionally, Bankruptcy Code § 363(m) provides that a purchaser who purchases assets in good faith cannot have a transaction unwound on appeal even if the appellant obtains a reversal of the order approving the 363 Sale. Thus a purchaser should obtain a finding from the bankruptcy court that it is a good faith purchaser. Then, in the event that: (i) an appeal is filed, (ii) the appellant does not obtain a stay of the 363 Sale approval order, and (iii) the sale closes, a substantial body of caselaw holds that the appeal should be dismissed as moot because the appellate court cannot unwind the transaction, and it would be a waste of appellate court resources to consider an appeal on which no relief can be granted.

Accordingly, the only practical method by which a 363 Sale can be stopped after it is approved by a bankruptcy court is for the aggrieved party to obtain a stay of the 363 Sale approval order from an appropriate court. [FN39] It is unlikely that a stay can be obtained without the posting of a bond. [FN40] The bankruptcy court has discretion in setting the bond amount. However, ordinarily the bond amount would be in an amount at least equal to the purchase price.

V. CONCLUSION

Bankruptcy offers a number of structural advantages not available elsewhere, including the ability to "wash" balance sheets. Because of the increasing frequency of bankruptcy filings generally, and 363 Sales specifically, both strategic and financial buyers are becoming increasingly comfortable with purchasing assets, or entire businesses, through bankruptcy. Moreover, due to the expertise of professional service firms and bankruptcy courts in this arena, the transaction costs are trending down as well. The savvy dealmaker should be on the lookout for good values on the steps of the bankruptcy courts in these difficult times.

[FN1]. A purchase of a distressed business, or assets of a distressed business, may be effected in a number of ways:

•Nonbankruptcy Purchase of Business or Assets: A distressed business need not enter bankruptcy in order to sell its assets. However, bankruptcy offers many advantages that will often warrant the transaction costs associated with it.
•Purchase of Assets in Bankruptcy Through a "363 Sale": Purchase through a 363 Sale is a tool of choice for the acquisition of distressed businesses

or their assets and are thus the focus of this article. •Purchase of Assets in Bankruptcy Through a Traditional Plan: The traditional method for buying and selling assets in bankruptcy has been through the confirmation of a Chapter 11 plan. Under certain circumstances, the traditional plan route may be more advantageous. In some cases, the advantages of a Plan can be realized more expediently (and thus with substantially less cost) through a "Prepackaged Plan." •Purchase of Assets or Control Position in Bankruptcy Through Purchase of Claims: It is possible to effect an acquisition of a debtor's assets (or control thereof) by purchasing a sufficient amount of claims against that debtor. While not rare, it is far less common than the 363 route and is not the focus of this article.

[FN2]. 11 U.S.C.A. § 365(c)(1)(A) precludes the assignment of an executory contract or lease if applicable nonbankruptcy law would excuse the other party from accepting performance from, or rendering performance to, an entity other than the debtor. Among the types of contracts that have been held nonassignable are personal service contacts, patent licenses where the debtor is a licensee, and government contracts. See In re Lil' Things, Inc., 220 B.R. 583, 590-91, 32 Bankr. Ct. Dec. (CRR) 793, 40 Collier Bankr. Cas. 2d (MB) 54 (Bankr. N.D. Tex. 1998) (all courts agree that section 365(c) applies to personal services contracts); In re CFLC, Inc., 89 F.3d 673, 29 Bankr. Ct. Dec. (CRR) 520, 36 Collier Bankr. Cas. 2d (MB) 297, 39 U.S.P.Q.2d 1518 (9th Cir. 1996) (federal patent policy warrants finding that federal law governs assignability of patent licenses; federal common law precludes such assignments); Matter of West Electronics Inc., 852 F.2d 79, 18 Bankr. Ct. Dec. (CRR) 287, Bankr. L. Rep. (CCH) P 72351, 34 Cont. Cas. Fed. (CCH) P 75526 (3d Cir. 1988) (rejected by, In re James Cable Partners, L.P., 154 B.R. 813, 24 Bankr. Ct. Dec. (CRR) 530, 28 Collier Bankr. Cas. 2d (MB) 1677, Bankr. L. Rep. (CCH) P 75313 (M.D. Ga. 1993)) (government contract could not be assigned because a federal statute barred the assignment of such contracts without the permission of the government); In re Valley Media, Inc., 279 B.R. 105, 135- 36, 47 U.C.C. Rep. Serv. 2d 1178 (Bankr. D. Del. 2002) (concluding that a nonexclusive copyright license was not assignable by a debtor); but see In re Hernandez, 285 B.R. 435, 438-42 (Bankr. D. Ariz. 2002) (refusing to hold that a patent license was assumable by a debtor despite the fact that the license granted the licensee some of the rights found in exclusive licenses). The Hernandez court appears to have based its decision on differences between the substantive rules and considerations used in determining whether an exclusive copyright license (which is generally held to be assignable) or patent license (which is generally held to not be assignable) is assignable, leading to different results between the two types of licenses.

[FN3]. Note that if a contract is deemed nonassignable in bankruptcy, the nondebtor contract party may have the immediate right to terminate the contract upon a debtor's filing for bankruptcy. Compare Valley Media, 279 B.R. at 138 (stating that the nondebtor counterparty to a nonassumable executory contract should file a motion for relief from the automatic stay to terminate the nonassumable contract) with Watts v. Pennsylvania Housing Finance Co., 876 F.2d 1090, 1095, 21 Collier Bankr. Cas. 2d (MB) 521, Bankr. L. Rep. (CCH) P 72915 (3d Cir. 1989) (finding no violation of the automatic stay when a nondebtor party terminated a nonassumable contract during a bankruptcy). Thus a prospective purchaser should perform adequate diligence to determine whether a contract that will be important or integral to a proposed sale will be assignable as part of a 363 Sale.

[FN4]. A prospective purchaser is not, however, permitted to "cherry pick" only favorable contracts from a group of integrated contracts. See In re Exide Technologies, 340 B.R. 222, 228, 46 Bankr. Ct. Dec. (CRR) 95 (Bankr. D. Del. 2006), appeal denied, judgment aff'd, 2008 WL 522516 (D. Del. 2008) (stating that all of the contracts that comprise an integrated agreement must either be assumed or rejected as a whole) (citing In re Philip Services (Delaware), Inc., 284 B.R. 541 (Bankr. D. Del. 2002), aff'd, 303 B.R. 574, 547-548 (D. Del. 2003)).

[FN5]. There are various waiting periods related to plan confirmation (e.g., 25 days' notice of disclosure statement hearing; 25 days' notice of confirmation hearing) and to approve a sale under Bankruptcy Code § 363 (20 days' notice of a sale are required under Fed. R. Bankr. P. 2002). Bankruptcy courts can, however, shorten the time requirements for a 363 Sale for good cause. Purchasers should be careful about demanding unreasonable time reductions as procedural due process must be provided to achieve proper notice and protection against collateral challenges to a plan or asset sale under section 363.

[FN6]. See Fed. R. Bankr. P. 2002.

[FN7]. But see sections 102(b)(2) and 302 of the Delaware General Corporation Law (allowing, under circumstances similar to a prepackaged plan of reorganization, a debtor to reach a "compromise" with its creditors and potentially to bind nonconsenting creditors).

[FN8]. One exception is exit consents in an exchange offer. Exit consents can be imposed by a majority or super-majority vote, thus stripping public bondholders of certain indenture protections. However, even in this instance, payment terms for a particular bondholder cannot be altered involuntarily.

[FN9]. But see note 2, supra.

[FN10]. The de facto merger doctrine focuses on whether a merger-in-fact of the seller into the purchaser took place, even if not legally documented as such. E.g., Steel Co. v. Morgan Marshall Industries, Inc., 278 Ill. App. 3d 241, 214 Ill. Dec. 1029, 662 N.E.2d 595, 29 U.C.C. Rep. Serv. 2d 649 (1st Dist. 1996). Under the mere continuity exception, a corporate successor is the continuation of the predecessor if only one corporation remains after the transfer of assets and there is

identity of stockholders and directors between the two corporations. Ninth Ave. Remedial Group v. Allis-Chalmers Corp., 195 B.R. 716, 724 (N.D. Ind. 1996). The "substantial continuity" doctrine is broader, and seems to focus on whether the sold business is continued in a close enough manner (same location, employees, name, etc.) such that a reasonable third person could not know a new owner has bought the business. Under any of these doctrines, would-be purchasers are most at risk under these doctrines if they are related to the seller or if they plan to continue the debtor's operations in a manner which would make it very difficult for a third party to know that a sale even took place. See also North Shore Gas Co. v. Salomon Inc., 152 F.3d 642, 652-655, 47 Env't. Rep. Cas. (BNA) 1001, 28 Envtl. L. Rep. 21500 (7th Cir. 1998).

[FN11]. In the current downturn, banks and other institutional investors and lending institutions are themselves increasingly distressed. This may result in banks favoring out-of-court settlements in more circumstances. In the past, borrowers likely had the luxury of time to work out a restructuring plan with a bank (tacit though such bank's approval may have been). Rather than analyzing one problem loan, lending officers will more likely consider such a loan's place in the bank's portfolio. A borrower's loan might be lumped in with other problem loans as part of a bulk write down of a banks assets. Also, banks today are more likely to sell participation interests or entire interests in loans, perhaps at a discount. Also, a bank may simply be too occupied dealing with larger problem loans--or its general portfolio of problem loans--to be able to spend significant time dealing with a borrower in a restructuring.

[FN12]. It remains an unanswered question as to whether the directors of a nearly insolvent corporation or corporation operating in the "zone of insolvency" owe fiduciary duties to creditors. The Delaware Chancery Court's decision in Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., 17 Del. J. Corp. L. 1099, 1991 WL 277613 at *34 (Del. Ch. 1991), indicated that such duties do exist, and recent Delaware Chancery Court and Delaware Supreme Court decisions have not resolved the question. See North American Catholic Educational Programming Foundation, Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007) (holding that no direct claims for breach of fiduciary duty may be brought by creditors of a corporation operating in the zone of insolvency but leaving open the question of whether directors of a nearly insolvent corporation owe creditors any fiduciary duties).

[FN13]. Although the courts are divided on the issue, most courts (including those in Delaware) have taken the view that when a corporation becomes insolvent, the duties of directors and officers expand such that they owe fiduciary duties to both creditors and shareholders. See Credit Lyonnais, 17 Del. J. Corp. L. 1099, 1991 WL 277613 at *34 (stating that where a corporation is operating in the vicinity of insolvency, the directors owe duties not merely to shareholders but to the entire corporate enterprise, including the corporation's shareholders); Geyer v. Ingersoll Publications Co., 621 A.2d 784, 789 (Del. Ch. 1992) ("The existence of the fiduciary duties at the moment of insolvency may cause directors to choose a course of action that best serves the entire corporate enterprise rather than any single group interested in the corporation at a point in time when the shareholders' wishes should not be the directors' only concern"). But see North American Catholic, 930 A.2d 92.

[FN14]. The rationale for the shift of fiduciary duties when a corporation is insolvent has been stated as follows: [W]hen a corporation is insolvent], the creditors become the enforcement agents of fiduciary duties because the corporation's wallet cannot handle the legal obligations owed.... In other words, the fiduciary duty tool is transferred to the creditors when the firm is insolvent in aid of the creditor's contract rights. Because, by contract, the creditors have the right to benefit from the firm's operations until they are fully repaid, it is they who have an interest in ensuring that the directors comply with their traditional fiduciary duties of loyalty and care. Any wrongful self-dealing, for example, injures creditors as a class by reducing the assets of the firm available to satisfy creditors. Trenwick America Litigation Trust v. Ernst & Young, L.L.P., 906 A.2d 168, 195 (Del. Ch. 2006), judgment aff'd, 931 A.2d 438 (Del. 2007).

[FN15]. Generally, the directors of a solvent corporation do not owe fiduciary duties to creditors; instead, creditor rights are governed by statute or contract. Simons v. Cogan, 542 A.2d 785 (Del. Ch. 1987), judgment aff'd, 549 A.2d 300 (Del. 1988); Katz v. Oak Industries Inc., 508 A.2d 873 (Del. Ch. 1986); Quadrangle Offshore (Cayman) LLC v. Kenetech Corp., 1999 WL 893575 (Del. Ch. 1999), judgment aff'd, 751 A.2d 878 (Del. 2000); Metropolitan Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504 (S.D. N.Y. 1989) (explaining that corporation was entitled to incur new debt in order to complete LBO, and bondholders had no basis for recovery absent a term in the indenture limiting such action).

[FN16]. A debtor has tremendous discretion as to whether to recommend a proposed purchaser's bid to the bankruptcy court. If the official committee of unsecured creditors (the Committee) wants a debtor to sell its assets and the debtor refuses, the usual remedy is to attempt to remove the debtor from control or to seek an end to the debtors "exclusive" right to file a Plan and, if successful, to then attempt to confirm its own Plan implementing the sale. These strategies are seldom implemented, and when they are, they are seldom successful.

[FN17]. Although section 363(b) does not require an auction for the sale of estate assets--indeed, under Bankruptcy Rule 6004, private sales are explicitly authorized--bankruptcy courts favor auctions because they have an "obligation in § 363(b) sales... to assure that optimal value is realized by the estate under the circumstances." In re Lahijani, 325 B.R. 282, 288- 89, 44 Bankr. Ct. Dec. (CRR) 247 (B.A.P. 9th Cir. 2005). Private sales are thus less frequently approved

by courts because "whenever there is only one bidder on a property competition is constrained," In re Schugg, 2006 WL 1455568 at *11 (D. Ariz. 2006), and the result of this constraint is that "the price [offered for estate property] is less likely to be reliable" or representative of the highest and best price obtainable for estate property. Lahijani, 325 B.R. at 289.

[FN18]. For example, in the rare case when the sale of a debtor's assets will be sufficient to pay off all of its creditors, the debtor's equity security holders will have the strongest interest in obtaining the highest and best value from a sale.

[FN19]. Stephens Industries, Inc. v. McClung, 789 F.2d 386, 390, 14 Collier Bankr. Cas. 2d (MB) 1298, Bankr. L. Rep. (CCH) P 71113 (6th Cir. 1986) (court can authorize a 363 Sale when there is a sound business purpose for doing so); In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (D. Del. 1999) (court should follow the "sound business purpose" test in determining whether or not to authorize a 363 Sale).

[FN20]. Breakup fees are standard and presumptively valid as an exercise of business judgment outside of bankruptcy. In re Integrated Resources, Inc., 147 B.R. 650, 23 Bankr. Ct. Dec. (CRR) 1042 (S.D. N.Y. 1992). They are generally permitted in bankruptcy. They must be approved specifically, however, by the bankruptcy court. Their purpose, inside and outside of bankruptcy, is to entice a stalking horse to come forward and stimulate the interest of other potential bidders. See In re O'Brien Environmental Energy, Inc., 181 F.3d 527, 533, 34 Bankr. Ct. Dec. (CRR) 879 (3d Cir. 1999). This enticement or inducement exists when a "break-up fee promote[s] more competitive bidding, such as by inducing a bid that otherwise would not have been made." O'Brien, 181 F.3d at 537; In re Beth Israel Hosp. Ass'n of Passaic, 2007 WL 2049881 at *13 (Bankr. D. N.J. 2007). While bankruptcy courts generally defer to a debtor's business judgment when approving or disapproving of a debtor's particular business decisions, bankruptcy courts sometimes take a harder look at breakup fees. In re America West Airlines, Inc., 166 B.R. 908, 913, 25 Bankr. Ct. Dec. (CRR) 891, 31 Collier Bankr. Cas. 2d (MB) 27, Bankr. L. Rep. (CCH) P 75895, Fed. Sec. L. Rep. (CCH) P 98249 (Bankr. D. Ariz. 1994) (stating that bid protection fees should not be approved if they will not induce further bidding or bidding generally). Factors sometimes considered include whether the stalking horse induced or catalyzed new bidders to bid for the debtor's assets, is related in any way to the debtor, and whether, in the court's view, the breakup fee would chill the submission of other bids. A general rule of thumb is that breakup fees which equate to about 3% or less of the proposed purchase price are approved, while breakup fees of greater amounts are more suspect. Depending on the jurisdiction and the factual context, the views of major parties-in-interest may be given significant defer ence. E.g., In re America West Airlines, Inc., 166 B.R. 908, 25 Bankr. Ct. Dec. (CRR) 891, 31 Collier Bankr. Cas. 2d (MB) 27, Bankr. L. Rep. (CCH) P 75895, Fed. Sec. L. Rep. (CCH) P 98249 (Bankr. D. Ariz. 1994) (a liquidating case; appropriate test held to be not whether the proposed breakup fee was within the debtors' business judgment but whether it was in the best interests of the debtor and the debtor's stakeholders). It should be noted that the America West court appears to hold its view of breakup fees regardless of the context in which they arise, having specifically adopted the view of Professor Bruce Markell, as illustrated in his article, "The Case Against Breakup Fees in Bankruptcy," 66 Am. Bankr. L.J. 349 (Fall 1992), which is to urge courts to generally scrutinize proposed breakup fees. America West appears to be an anomaly. It is essential that potential purchasers cause the debtor to obtain approval of the desired breakup fee as early in the process as possible, because if the purchaser pro ceeds despite not receiving such approval, a court may refuse to grant the breakup fee on the basis that it was not a prerequisite for the bid. O'Brien, 181 F.3d at 537.

[FN21]. In some cases, a bankruptcy court may even reopen an auction to permit the consideration of additional bids for a debt or's assets. See Corporate Assets, Inc. v. Paloian, 368 F.3d 761, 43 Bankr. Ct. Dec. (CRR) 4, Bankr. L. Rep. (CCH) P 80103 (7th Cir. 2004) (affirming a bankruptcy court's decision to reopen an auction so that a prospective purchaser could increase its bid).

[FN22]. See In re Bakalis, 220 B.R. 525, 532, 32 Bankr. Ct. Dec. (CRR) 232 (Bankr. E.D. N.Y. 1998) (appropriate standard has been enunciated in several ways, these variations all fall under the rubric of the business judgment test); In re Schipper, 933 F.2d 513, 515, 21 Bankr. Ct. Dec. (CRR) 1245, Bankr. L. Rep. (CCH) P 74004 (7th Cir. 1991) (stating that sales are an exercise of a fiduciary duty that requires an "articulated business justification"). This standard is the same standard as that discussed in Part IV.A supra. It should be understood that the authorities cited in this footnote set forth the appropriate standard for any sale under Bankruptcy Code § 363. The discussion in Section IV.A, on the other hand, focuses on when a debtor may sell all or substantially all of its assets in a 363 Sale, and the cases cited in that section discuss that more specific question.

[FN23]. In re Delaware & Hudson Ry. Co., 124 B.R. 169, 176 (D. Del. 1991).

[FN24]. Matter of Phoenix Steel Corp., 82 B.R. 334, 335-36 (Bankr. D. Del. 1987) (sale must be "fair and equitable" and in "good faith").

[FN25]. The Hart-Scott-Rodino (HSR) Antitrust Improvements Act of 1976 (15 U.S.C. § 18a) requires target companies and their prospective buyers to notify the Federal Trade Commission and the U.S. Department of Justice before completing transactions such as mergers and acquisitions. The agencies use this information to determine if the proposed transaction may be anticompetitive and take enforcement action, if appropriate, to prevent the consummation of transactions that violate § 7 of the Clayton Act. Only after observing the waiting period under

the HSR may the companies complete the proposed transaction.

[FN26]. See In re NextWave Personal Communications, Inc., 200 F.3d 43, 35 Bankr. Ct. Dec. (CRR) 122 (2d Cir. 1999).

[FN27]. See supra note 2.

[FN28]. In re Quanalyze Oil & Gas Corp., 250 B.R. 83, 89, 44 Collier Bankr. Cas. 2d (MB) 893 (Bankr. W.D. Tex. 2000); citing In re HST Gathering Co., 125 B.R. 466, 468 (W.D. Tex. 1991) (competing bidders normally lack standing to "even challenge a sale, much less seek reconsideration of an order approving a sale"); but see In re Colony Hill Asso ciates, 111 F.3d 269, 30 Bankr. Ct. Dec. (CRR) 832, Bankr. L. Rep. (CCH) P 77383 (2d Cir. 1997) (unsuccessful bidder accorded standing, in order to expose collusion that undermined the intrinsic fairness of the sale transaction). However, the Bankruptcy Code provides that any creditor is a "party in interest" with the right to be heard on any issue in the bankruptcy proceedings. Therefore, a competitive bidder may be able to obtain standing to object to unfair auction procedures by buying a small claim against the debtor.

[FN29]. See, e.g., O'Brien, 181 F.3d at 531 (recognizing that a bidder has standing to challenge the "intrinsic process" by which assets are sold in a bankruptcy); In re Colony Hill Associates, 111 F.3d 269, 273-74, 30 Bankr. Ct. Dec. (CRR) 832, Bankr. L. Rep. (CCH) P 77383 (2d Cir. 1997) (concluding that a bidder had standing to challenge the intrinsic fairness of a sale when the bidder asserted that the debtor and its creditors unlawfully sought to ensure that no auction took place).

[FN30]. E.g., Ninth Ave. Remedial Group v. Allis-Chalmers Corp., 195 B.R. 716, 722 (N.D. Ind. 1996) (citing Chicago Truck Drivers, Helpers and Warehouse Workers Union (Independent) Pension Fund v. Tasemkin, Inc., 59 F.3d 48, 27 Bankr. Ct. Dec. (CRR) 591, 33 Collier Bankr. Cas. 2d (MB) 1456, 19 Employee Benefits Cas. (BNA) 1463, Bankr. L. Rep. (CCH) P 76547 (7th Cir. 1995).

[FN31]. The court in Ninth Ave. Remedial Group summarized the exceptions as follows: "There are four exceptions... (1) the purchaser explicitly or implicitly agrees to assume liability; (2) the transaction amounts to a de facto merger or consolidation; (3) the purchasing corporation is merely a continuation of the seller; or (4) the parties negotiated the transaction fraudulently to escape liability." Ninth Ave. Remedial Group, 195 B.R. at 722 (citing U.S. v. Mexico Feed and Seed Co., Inc., 980 F.2d 478, 487, 35 Env't. Rep. Cas. (BNA) 1761, 24 Fed. R. Serv. 3d 1032, 23 Envtl. L. Rep. 20461 (8th Cir. 1992)).

[FN32]. See, e.g., In re Fairchild Aircraft Corp., 184 B.R. 910 (Bankr. W.D. Tex. 1995), decision vacated on other grounds , 220 B.R. 909, 32 Bankr. Ct. Dec. (CRR) 742 (Bankr. W.D. Tex. 1998) (stating in dicta that sale free and clear concerned only in rem interests, not in personam interests such as might be held by personal injury claimants). The dispute, at the most base level, is over the meaning of section 363(f) of the Bankruptcy Code. That section permits a sale of property "free and clear of any interest in such property" if certain conditions are satisfied. Courts have not interpreted these words consistently. Ninth Ave. Remedial Group, 195 B.R. at 730. Courts such as Fairchild Aircraft take a narrow view. Other courts interpret section 363(f) more broadly, using section 363(f) to preclude claims against successors who purchased assets in a sale even when the claims are not based on in rem interests. See Ninth Ave. Remedial Group, 195 B.R. at 730-31 (collecting cases).

[FN33]. Liability, when it is imposed, is based on a successor liability theory called the "product line exception." Under the product line exception, a purchaser is strictly liable for defects in products made by its predecessor if the purchaser continues to sell the product under the same trade name and the plaintiff lacks a potential remedy against the predecessor. Ninth Ave. Remedial Group, 195 B.R. at 726-727. Compare Zerand-Bernal Group, Inc. v. Cox, 23 F.3d 159, 25 Bankr. Ct. Dec. (CRR) 965, 30 Collier Bankr. Cas. 2d (MB) 1763, Bankr. L. Rep. (CCH) P 75862 (7th Cir. 1994) (bankruptcy court order approving a sale free and clear of any liens, claims, or encumbrances of any sort or nature did not bar injured party from asserting claims against purchaser, on the basis that the plaintiff was not trying to enforce a lien) with In re White Motor Credit Corp., 75 B.R. 944, 952, 16 Bankr. Ct. Dec. (CRR) 217, 17 Collier Bankr. Cas. 2d (MB) 293 (Bankr. N.D. Ohio 1987) ("successor liability is precluded by section 1141(c) which specifically frees debtor's property from creditors' claims").

[FN34]. The issue, regardless of the context in which the successor liability question arises, will often turn on which view of section 363(f) the bankruptcy court follows. However, this is not always so, and is very apparent in the environmental context. For example, as the Ninth Ave. Remedial Group court stated: In deciding whether the sale... precludes successor liability for Plaintiffs' CERCLA claims, the Court does not have to decide what type of interests are covered by the section 363(f) language, because the Court can decide on other grounds... [I] f the CERCLA claim could have been a claim in bankruptcy against [the seller]... the bankruptcy court had the equitable power to discharge the claim against the asset purchaser independently of section 363(f). If the claim arose after the consummation of the bankruptcy proceedings, the bankruptcy court did not have the power to discharge the claim. Ninth Ave. Remedial Group, 195 B.R. at 731.

[FN35]. E.g. In re Leckie Smokeless Coal Co., 99 F.3d 573, 36 Collier Bankr. Cas. 2d (MB) 1693, 20 Employee Benefits Cas. (BNA) 2103, 78 A.F.T.R.2d 96-7021 (4th Cir. 1996) (assets sold free and clear of debtor's pension plan obligations).

[FN36]. In certain states, a buyer of assets in bulk is automatically liable for all of the liabilities if a creditor sues the buyer within six months after the acquisition, unless notice was given

to all of the seller's creditors within a specified period of time before the sale and certain other procedures were followed. However, very few states still follow the Bulk Sales Act, UCC Article 6, as it was originally drafted. In 1989, the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI) recommended that states repeal Article 6, after noting that the burdens to purchasers of businesses under the bulk sales provisions were no longer justified by the benefits to the creditors of sellers of businesses.

[FN37]. See In re Piccadilly Cafeterias, Inc., 379 B.R. 215 (S.D. Fla. 2006), aff'd, 484 F.3d 1299, 48 Bankr. Ct. Dec. (CRR) 25, 57 Collier Bankr. Cas. 2d (MB) 129, Bankr. L. Rep. (CCH) P 80903 (11th Cir. 2007), cert. granted, 128 S. Ct. 741, 169 L. Ed. 2d 579 (U.S. 2007) and rev'd and remanded, 128 S. Ct. 2326, 171 L. Ed. 2d 203, 50 Bankr. Ct. Dec. (CRR) 34, Bankr. L. Rep. (CCH) P 81257 (U.S. 2008) (stating that the section 1146 transfer tax exception may apply to preconfirmation sales of assets under section 363 provided there is a nexus between the preconfirmation sale and a subsequently confirmed plan); but see In re Hechinger Inv. Co. of Delaware, Inc., 335 F.3d 243, 257, 41 Bankr. Ct. Dec. (CRR) 162, Bankr. L. Rep. (CCH) P 78886 (3d Cir. 2003) (holding that a sale may benefit from section 1146 only if the sale is authorized by the "terms of a previously confirmed Chapter 11 plan").

[FN38]. See In re Clinton Street Food Corp., 254 B.R. 523, 45 Collier Bankr. Cas. 2d (MB) 163 (Bankr. S.D.N.Y. 2000) (section 363(n) allows a trustee to either avoid a collusive sale of estate assets or recover damages, including punitive damages, from any entity who enters into a collusive agreement). Moreover, in some circumstances, collusive bidding may subject the colluding parties to criminal prosecution. See 18 U.S.C.A. § 152(6).

[FN39]. See In re Whistler Corp. of Massachusetts, 243 B.R. 573, 574 (D. Mass. 2000) (the general rule of section 363(m) is that the failure of an appellant to stay a sale to a "good faith purchaser" pending its appeal precludes appellate review of the sale order on the basis of mootness); In re Gucci, 105 F.3d 837, 839, 30 Bankr. Ct. Dec. (CRR) 350, 37 Collier Bankr. Cas. 2d (MB) 632, 41 U.S.P.Q.2d 1636, Bankr. L. Rep. (CCH) P 77278 (2d Cir. 1997) (failure to obtain stay of order approving sale deprives appellate court of jurisdiction to determine any issue other than good faith of purchaser). A second potential (but usually unsuccessful) avenue of attack exists under Fed. R. Civ. P. 60(b), incorporated by reference into the Federal Rules of Bankruptcy Procedure, in the case of fraud or similar conduct. E.g. Matter of Edwards, 962 F.2d 641, Bankr. L. Rep. (CCH) P 74611, 23 Fed. R. Serv. 3d 246 (7th Cir. 1992).

[FN40]. See In re Byrd, 172 B.R. 970, 26 Bankr. Ct. Dec. (CRR) 71 (Bankr. W.D. Wash. 1994) (posting a supersedeas bond under Rule 7062(d) in an amount approved by the court gives the judgment debtor an absolute right to stay pending appeal, alternatively, a court has discretion to grant a stay pending appeal under Fed. R. Bankr. P. 8005 and 7062(c) and need not require the posting of a supersedeas bond).

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