

Asset Sales in Bankruptcy: An Effective Means to Realize the Maximum Value of a Distressed Company

Despite certain recent and modest signs of improvements in the United States economy, many businesses continue to struggle financially and may be forced to explore every option to survive the economic downturn. When faced with tough challenges, one option a business may consider is the reorganization of the business, including the possibility of a sale of part or all of the business, through Chapter 11 of the United States Bankruptcy Code.

Chapter 11 can provide economically challenged companies the ability to restructure debts through a plan of reorganization and/or to sell unwanted assets through the asset sale provisions of the Bankruptcy Code. Asset sales, sometimes called "363 Sales" because they are governed by Section 363 of the United States Bankruptcy Code, have become increasingly used as a means for realizing the maximum value of a distressed company. The sales of "good assets" by General Motors and Chrysler Corporation in their respective Chapter 11 bankruptcy cases during the summer of 2009 were headline-making news. The size and complexity of these two automakers and the urgency of the survival of General Motors and Chrysler resulted in Court approved bankruptcy sales which took place at record-breaking speed. Sales of assets for other businesses may not take place so quickly, but can be carried out efficiently and can enable a struggling business to get its fresh start.

Section 363 of the Bankruptcy Code permits the bankrupt company (known as the debtor or the debtor-in-possession) to sell some or all of its assets to the highest bidder. The Bankruptcy Code also permits the business owner to reject unfavorable contracts and/or leases or assign such contracts or leases that are economically favorable to a new purchaser. Asset sales allow the seller (identified in this article as the debtor) to realize the maximum

value for any one of its assets or its entire business. The goal of a debtor's asset sale should be to obtain the highest price for the property sold. The pool of money generated from an asset sale or series of sales enables the debtor to pay off its debts through a plan of reorganization. A sale of assets by a debtor in a Chapter 11 case differs from the sale of assets in a Chapter 7 case. Chapter 7 cases are liquidation cases administered by a Chapter 7 Bankruptcy Trustee. In a Chapter 7 case, the business owner simply files the case, no longer has any involvement with the business and the Chapter 7 Trustee takes possession of all of the business assets and promptly liquidates them. In a Chapter 11 case, the business owner generally stays involved in the case overseeing the reorganization and/or sales process.

Procedures for Effectuating Asset Sales

Whether the sale is small or large, the procedures for effectuating the sale are similar. In order to sell assets (other than routine merchandise sold by a business), a debtor must obtain bankruptcy court approval. A debtor's determination to sell its assets is governed by the "business judgment rule." The debtor must determine, and the bankruptcy court must agree, that in the debtor's business judgment, the proposed sale is fair and reasonable, that there has been adequate marketing of the assets to be sold, that the sale has been negotiated and proposed in good faith, and that the buyer is proceeding in good faith. In order to accomplish these objectives, bankruptcy courts typically require that the proposed sale be adequately exposed to the marketplace and subject to bids from other parties.

In the case of a larger business, the debtor may require the services of a financial advisor. A financial advisor is the business counterpart to the legal

expertise of the debtor's bankruptcy counsel. A financial advisor will analyze the debtor's assets proposed to be sold and create a package of information about the assets. Next, the financial advisor will market the assets to a target market.

The debtor, with or without a financial advisor, then may attempt to locate a stalking horse bidder, which is an individual or entity who agrees to purchase the assets at an agreed upon price, signs a purchase agreement, and commits to close on the purchase of assets at that price. The stalking horse bidder eliminates uncertainty because the debtor knows that, in the worst case scenario, if the debtor does not receive another offer for the assets, the debtor has a buyer lined up and can move forward with the asset sale. If other bidders are located, the offer of the stalking horse bidder is considered the floor and an auction takes place. The stalking horse bidder typically receives a fee, called a break-up fee or stalking horse fee, for the reimbursement of its professional fees or other costs actually incurred if it is outbid at an auction. If an auction does take place, the high bid is presented to the bankruptcy court for approval and, if approved, the parties can close on the sale of the assets.

Asset Sales Free and Clear of Liens

The debtor's assets are likely to be sold at a higher price if they can be sold without any liabilities. When a debtor files a motion seeking authorization to sell its assets, it typically asks the bankruptcy court to approve the sale of assets free and clear of liens. Such liens can include mortgages, liens and security interests of banks and other financial institutions, and even lawsuit judgments which attach to the assets of a debtor. Debtors seek authority to sell the assets free and clear of liens so that the buyer can obtain clear title to the assets, unencumbered with any secured lender's liens and old debts.

In such a sale, the buyer acquires the asset free and clear of the lien holder's interest, but the lien holder does not lose its lien. The lien holder's interests attach to the proceeds of the sale and remain within the debtor's bankruptcy estate.

Other Advantages to Asset Sales in Bankruptcy

As noted above, one of the most commonly utilized benefits of a Chapter 11 filing is the ability for the debtor to reject unfavorable contracts and leases and, of course, retain those contracts and leases they believe are favorable. In the situation where a sale of assets is taking place, any favorable contracts and leases can be assigned to the new owner if it so chooses. If the entire business is being sold, the prospective new owner can analyze and determine which contracts it seeks to have assigned to it, and those it does not need can be rejected.

Asset sales provide the debtor with an efficient and effective means to accomplish a reorganization of the business or a sale of the entire business. Whether the asset sale is achieved through a single sale or a series of sales, the ultimate goal of the sale is to obtain the highest and best purchase price for the benefit of the debtor and its creditors. Because asset sales provide the debtor with flexibility to achieve a successful reorganization, the number of asset sales conducted in the bankruptcy courts will continue to increase. In today's troubled economy, it is an option that should not be overlooked.

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