**TIPPING the BALANCE**

**Due to their relative speed and the advantages they afford both buyer and seller, section 363 sales are becoming the preferred method of selling the assets of a company in bankruptcy.**

The current recession has significantly increased opportunities for buyers to purchase the assets of financially distressed companies in bankruptcy. Section 363 of the Bankruptcy Code allows a debtor to sell all, or substantially all, of its assets outside of the ordinary course of business. Commonly referred to by bankruptcy practitioners as “Section 363 sales,” these sales involve a court-supervised open auction of a debtor’s assets, and are designed to generate the highest and best offer for the assets. Such sales have become very common in large-scale corporate bankruptcy cases, especially where all or a part of a debtor’s assets are likely to lose value during the course of a lengthy bankruptcy proceeding. Many large and well-known companies have sold assets in their bankruptcy proceedings under Section 363, including **TWA, Enron, Polaroid, Lehman Brothers, General Motors and Chrysler**. In the Chrysler proceedings, for example, the debtor used Section 363 to sell substantially all of its operating assets, including manufacturing plants, brand names, and certain dealer and supplier relationships, to a newly created company. In exchange, the new company assumed certain liabilities and paid $2 billion in cash. The sale was completed in less than two months.

Section 363 sales offer many advantages over the traditional process of selling a company’s assets under a plan of reorganization. When a company’s assets are sold under a plan of reorganization, the prospective sale is described in detail in a disclosure statement, and the bankruptcy court can approve the plan of reorganization only if it is accepted and voted on by a specified majority of parties under the plan. This process is inevitably very time-consuming and expensive.

**MAXIMIZING ASSET VALUES**

Section 363 sales, on the other hand, allow a company to sell its assets to a buyer in an expedited process. Especially useful where a debtor needs to sell its assets quickly so that they do not lose value, a Section 363 sale can be accomplished in a period of only two or three months. The value of the debtor’s assets can be maximized because the expedited time frame allows the debtor to sell its business as a going concern. At the same time, the purchaser can choose which liabilities of the debtor’s business it will assume and which liabilities it will not assume. Therefore, the debtor is in a good position to obtain the highest possible price for its assets.

For example, the United States Court of Appeals for the Second Circuit found that a Section 363 sale of substantially all of Chrysler’s operating assets was appropriate where Chrysler’s “(g)oing concern value was being reduced each passing day that it produced no cars, yet was obligated to pay rents, overheads, and salaries.”

**ADVANTAGES FOR BUYERS, TOO**

From the purchaser’s perspective, a Section 363 sale also offers the opportunity to acquire assets (with certain limited exceptions) free and clear of any liens, claims and encumbrances, so long as certain conditions specified in the Bankruptcy Code are met. Further, the Second Circuit recently held that Section 363(f) of the Bankruptcy Code allows a debtor to sell its assets to the purchaser free and clear of “successor liability” for pre-petition tort claims. In addition, a creditor with a valid security interest in the assets will often have the opportunity to “credit bid” by setting off the amount of the debt it is owed by the debtor against the purchase price of the assets.

In view of the above, it is fair to say that Section 363 sales have become the preferred method for selling the assets of a company in bankruptcy. This is especially true today because, in the current economic downturn, fewer debtors are able to find lenders willing to provide financing. As the Second Circuit recently noted, the “side door” of Section 363 sales “may well replace the main route of Chapter 11 reorganization plans.”

Given the current economic climate, we will undoubtedly see more debtors sell their assets in Section 363 sales, and there will be many opportunities for the savvy purchaser to acquire the valuable assets of financially distressed businesses through this bankruptcy process.

**SECTION 363 SALES: AN OVERVIEW**

In a Section 363 sale, a debtor actively markets its assets to potential purchasers. The debtor then selects an initial bidder to set the bidding floor and, assuming there are qualifying, competing bids, sells its assets in an open auction designed to ensure that the debtor obtains the highest and best price for its assets.

**STEP 1: SET THE BIDDING FLOOR**

The party who sets the bidding floor by providing the initial offer to purchase the debtor’s assets is colloquially referred to as the “stalking horse.” The stalking horse will likely demand protections for its efforts, such as a “break-up” fee and expense reimbursement up to an agreed-upon amount. Break-up fees and expense reimbursements are designed to protect the stalking horse financially in the event that it is out-bid at the auction, and typically compensate the stalking horse for all of the expenses it incurred in conducting its due diligence and negotiating with the seller. A bankruptcy court will determine whether to approve these protections on a case-by-case basis, and will only approve these protections if the court finds that they encourage — and do not “chill” — competitive bidding. These amounts are usually paid from the proceeds of the higher and better offer.

**STEP 2: THE ASSET PURCHASE AGREEMENT**

After the stalking horse is selected, the debtor enters into an asset purchase agreement (APA) with the stalking horse. When a sale involves leases or executory contracts, the APA will also contain a schedule of the agreements that the debtor intends to assign to the purchaser. Before a contract or lease can be assigned to a purchaser, a debtor must demonstrate that the purchaser has cured or will promptly cure all existing defaults under the agreement, and must also demonstrate that the purchaser can provide adequate assurances of future performance under the agreement.

**STEP 3: THE BIDDING PROCESS**

The stalking horse’s offer to purchase the debtor’s assets is subject to “higher and better” offers. The debtor’s counsel will draft bidding procedures, which include a description of the requirements for competing bids to be accepted. Bidding procedures typically contain minimum increments for overbids, and qualification requirements for competing bidders. Bidding procedures are likely to be approved by the bankruptcy court if such procedures are, in the debtor’s reasonable business judgment, likely to maximize the sale price, and do not “chill” the receipt of higher and better offers.

**STEP 4: THE AUCTION AND THE SALE ORDER**

The debtor’s counsel will ask the bankruptcy court to set a date for an auction of the debtor’s assets. The auction is an open auction, and commonly takes place in the office of the debtor’s counsel, although it could also take place in the courthouse, or at a location chosen by a professional auctioneer, if one is being used. After the auction is completed, the debtor selects the highest and best bid, and the debtor’s counsel asks the bankruptcy court to enter an order approving the sale to the successful bidder at the auction.