What you Need to Know before your next 363 Sale

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South Carolina Bankruptcy Law Association
Annual Convention

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[1] Kimberly Newton, law clerk at the McCarthy Law Firm, LLC, prepared the written materials. However, she is not responsible for what the speakers actually say during the roundtable discussion.

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Pre-Confirmation Sales

The use of Section 363 to sell substantially all of the debtor's assets outside a plan is quite ordinary and has been used for some time.[2] Despite some criticism, troubled companies are increasingly using 363 as an alternative exit from bankruptcy to minimize the expense and duration of the process.[3] To sell all of the debtor's assets free and clear of all liens and encumbrances prior to confirmation, the debtor must satisfy the provisions of 363(b)(1)[4] and 363(f).[5] The use of 363(b) allows the debtor to achieve a quick

[2] K. Scott Van Meter, *Lessons Learned from the GM and Chrysler Bankruptcy*, 6 No. 11 Andrews Bankr. Litig. Rep. 1, October 2, 2009.
[3] Rose, Elizabeth B., *Chocolate, Flowers, and § 363(B): The Opportunity for Sweetheart Deals without Chapter 11 Protections*, 23 Emory Bankr. Dev. J. 249, 249 (2006).
[4] 11 U.S.C. 363(b)(1):
The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless—
(A) such sale or such lease is consistent with such policy; or
(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—
(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and
(ii) finding that no showing was made that such sale or such lease would violate applicable bankruptcy law.

[5] 11 U.S.C. 363(f) provides:
The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—
(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
(2) such entity consents;
(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
(4) such interest is in bona fide dispute; or
(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

approval of the sale of all or substantially all of its assets prior to a plan confirmation. Nothing in 363(b) itself requires a Chapter 11 debtor to file a plan of reorganization before selling all of its assets.

In almost all cases in this district the court expects, and probably demands, the disclosure statement and plan be filed prior to the 363 sale hearing. In fact, in a Supplemental Order intended to provide guidance to the Bar, the court recognized that the need to sell assets before approval of a disclosure statement and plan is not uncommon, but also noted that "filing [a disclosure statement and plan] before a sale better informs all creditors of what to expect in the case, including the details of their treatment and anticipated distribution." *In re Bellwright Industries, Inc.,* Supplemental Order, Case No. 08-01597-JW (Bankr. D.S.C. Jun. 18, 2008).

Critics of 363 preconfirmation sales have described the process as "hijacking chapter 11" or "side-stepping creditor protections" associated with the Plan confirmation process, such as the duty to provide adequate information to parties in interest. To prevent a debtor from using 363(b) to circumvent creditor protections under Chapter 11, many courts, including South Carolina, have adopted the "sound business purpose" test for allowing liquidation sales prior to confirmation.

The "sound business purpose" test has four elements:

(1) a sound business reason or emergency justifies a pre-confirmation sale;

(2) the sale has been proposed in good faith;

(3) adequate and reasonable notice of the sale has been provided to interested parties; and

(4) the purchase price is fair and reasonable.

In re WBQ Partnership, 189 B.R. 97 (Bkrtcy. E.D.Va. 1995). South Carolina officially adopted the sound business purpose test in *In re Taylor*, 198 B.R. 142, 157 (Bkrtcy. D.S.C. 1996).

Mechanics for Conducting a 363 Sale

There are two ways to conduct a 363 Sale. The first method is a straight auction sale on a set date to an unknown buyer and obviously for an unknown amount. Such sales may be with or without reserve. A second method, more often used in this district, is to have a so-called directed sale, sometimes known as a stalking horse sale.

Stalking Horse

Typically the debtor will identify a "stalking horse" prior to providing notice of a sale or asking the court to approve bidding procedures, and sometimes even prior to filing bankruptcy. A stalking horse is an initial bidder in the 363 sale process and provides many benefits to the debtor, as well as to other parties interested in bidding on the assets. The stalking horse (1) identifies issues through due diligence; (2) attracts other bidders; (3) provides a floor price at the auction; and (4) negotiates an Asset Purchase Agreement or, failing that, a letter of intent [LOI], or, even worse, a term sheet. Courts have even approved sales in exigent circumstances where Debtor's counsel has been unable to do his job of creating an APA or LOI and the hapless Debtor's counsel has merely proffered a term sheet. *In re Renaissance Park Hotel, LLC*, Case No. 06-04893 (Bankr. D.S.C. Nov. 19, 2007) (No. 284).

In exchange for these benefits, the stalking horse often receives buyer protections, which require court approval. The most common buyer protection in South Carolina is an expense reimbursement fee. The fee is subject to court approval and

designed to reimburse the stalking horse for expenses incurred in reaching the auction and sale process. The fee is capped at a certain amount and includes direct and indirect expenses. The stalking horse must provide documentation of actual and reasonable incurred costs to receive reimbursement.

Another form of buyer protection, generally disfavored in this district, is a break-up fee, which is a fee given to the stalking horse should another competitive bid be accepted. Courts review break-up fees on a case by case basis. Our court has provided a list of factors to consider in evaluating a break-up fee:

> 1) Whether the fee requested correlates with a maximization of value to the debtor's estate; 2) Whether the underlying negotiated agreement is an arms-length transaction between the debtor's estate and the negotiating acquirer; 3) Whether the principal secured creditors and the official creditors committee are supportive of the concession; 4) Whether the subject break-up fee constitutes a fair and reasonable percentage of the proposed purchase price; 5) Whether the dollar amount of the break-up fee is so substantial that it provides a "chilling effect" on other potential bidders; 6) The existence of available safeguards beneficial to the debtor's estate; and 7) Whether there exists a substantial adverse impact upon unsecured creditors, where such creditors are in opposition to the break-up fee.

In re Paintball, Inc. Case No. 03-08807 (Bankr. D.S.C. Oct. 16, 2003) (citing *In re Hupp Industries, Inc.* 140 B.R. 191, 194 (Bankr. N.D. Ohio 1992)).

The court determined in *In re Paintball, Inc.* that a break-up fee of 7.5% of the initial purchase offer was excessive.[6] While reasonable break-up fees are not subject to an easy application of a range of percentages, some important considerations in arriving at an appropriate fee include the purchase price, the need of having an initial offer to stimulate bidding, the cost of investigation a potential purchaser may incur, and the ratio

[6] The court cited to *In re Integrated Resources Inc.*, 135 B.R. 746 (Bankr. S.D.N.Y. 1992), aff'd, 147 B.R. 650 (S.D.N.Y. 1992) in which the court heard expert testimony that the industry standard for break-up fees averaged 3.3%. The court ultimately approved a break-up fee that was 1.6% of the proposed purchase price of $565 million.

or the potential value of the property to be acquired to the cost of acquisition. *Id*. And, of course, one has to take into account the absolute dollar amount of the fee compared to the total amount of the debt.

In *In re Georgetown Steel, Inc.*, Case No. 03-13156 (Bankr. D.S.C. May 13, 2004), the court approved a break-up fee and expense reimbursement fee higher than customary because of certain factors present: 1) the need to expeditiously move toward a sale of assets during a time when the market for such assets has rebounded; 2) the fact that the Debtor is essentially in a non-operating mode as well as the prospect of re-employment for hundreds of employees and resulting revitalization of the Georgetown community; 3) the time, efforts, and funds expended, and expertise needed, in order to bring about a buyer for a non-operating entity in the steel industry market; 4) and finally the consents of the Committee and the United States Trustee.

What should be included in a Sale Motion

The sale motion asks the court to approve the terms of the proposed sale and to authorize the assumption or rejection of certain executory contracts. Typically, the sale motion will provide a background of the case and the terms of the proposed sale. The sale motion will also describe how the sale proceeds are to be distributed among secured creditors or that the proceeds will be held pending further order of the court.

The best standard of practice is to include a "waterfall provision," described as such because it shows the levels of payment each class will receive from top to bottom of the creditor pool. Insofar as the Debtor can show payments in full to each of the successive senior classes, then their consent is almost automatic and the Debtor can then focus on maximizing the return for the unsecured class of creditors. Insofar as secured

creditors are not being paid in full, the Debtor needs to obtain their consent to the sale and also negotiate a carve out with them. If the secured creditor does not consent, the Debtor needs to re-evaluate the issue of the likelihood of success at a contested sale hearing.

If the above is done precisely and at the beginning of the case, the waterfall paragraph will outline the basics for the disclosure statement and the plan, which can then be promptly filed so that the court can be more comfortable in approving the sale and creditors will know their treatment under the proposed plan.

The sale motion should also lay out the elements of the sound business purpose test and describe why each element is met in the case before the court. In addition to satisfying the sound business purpose test, the debtor must also satisfy at least one of the five conditions listed in 363(f) in order for the property to be sold "free and clear of any interests":

> **(1)** applicable nonbankruptcy law permits sale of such property free and clear of such interest;
> **(2)** such [secured party] consents;
> **(3)** such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
> **(4)** such interest is in bona fide dispute; **or**
> **(5)** such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. 363(f)

South Carolina bankruptcy courts have interpreted "interest" as used in 363(f) more broadly than to just cover liens. *In re Taylor*, 198 B.R. 142 at 161.

Carve Outs

Historically, bankruptcy courts do not view themselves as an alternative to a state court foreclosure process. That is to say if the DIP or Trustee is proposing a sale where

the only parties to benefit are the secured creditors and the professionals, the court will generally disapprove the sale. To that end, sellers should propose a "carve out" for priority or unsecured creditors. This carve out can range from 1% (*See In re Renaissance Park Hotel, LLC*, Case No. 06-04893 (Bankr. D.S.C. Nov. 19, 2007) to over 20% (*See In re Pulliam Motor Company d/b/a Pulliam Ford*, Case No. 07-01555-dd (Bankr. D.S.C. Apr. 17, 2007).

In the early 1980's, Judge Davis became concerned that Section 363 sales were benefitting only banks and trustees/DIPs. He asked that sellers consider paying unsecured creditors an amount equal to what was being paid to trustees, who, at that time, had a 3% sales commission enshrined in the Bankruptcy Code. Eventually, 3% became 5% as Congress amended the compensation tariff for trustees. The 5% payout to unsecured creditors became 10% as committees and the court worried about a *de minimis* payment in larger cases, and 10% even expanded to 20% in certain cases where speed was particularly important to the seller, purchaser, and the bank. There is a so-called "public policy" exception to this ascending progress of payment under the carve out. (*See In re Renaissance Park Hotel, LLC,* Case No. 06-04893 (Bankr. D.S.C. Nov. 19, 2007)). One can also reasonably anticipate that in sales where there are significant issues about employee retention, courts may be sympathetic to a reduction in the proposed carve out (*See In re StarTrans Inc.,* Case No. 09-07468 (Bankr. D.S.C. Nov. 5, 2009)).

Bidding Procedures

Purpose

After identifying a stalking horse and negotiating an asset purchase agreement, the debtor will ask the court to approve bidding and other procedures for conducting the

sale. Requiring court approved bidding procedures provides formalities and order to the sales process. Prior to the courts requiring bidding procedures, the auction process was unorganized and courts were often faced with having to choose between bids with significantly different terms.

Approval and Terms of Bidding Procedure Motion

In South Carolina, the bid procedure motion is either conducted ex parte or after notice and a hearing, depending on the judge's preference. The motion can be heard on an expedited basis. The Bid Procedure Order will set forth:

a. Solicitation Procedures:

- How to qualify potential bidders;
    - Interested bidders may have to sign a confidentiality agreement.
- How potential purchasers are to submit their bids;
    - The competitive bid must be in writing.
    - Bidders will have to submit an earnest money deposit with their bid.
    - The terms and conditions of the competing bid must be identical or substantially similar to the APA of the stalking horse.
        - This requirement makes it easier to compare the bids.
    - The deadline for submitting bids to the Debtor's attorney and the stalking horse's attorney is a stated number of days prior to the Sale hearing.

b. Auction Procedures:

- Date the auction will be held in the event qualified competing bids are submitted.
- Requirement that all bids be in minimum incremental amounts.
- Requirement that the initial topping bid exceed the current bid by a certain dollar

amount, which includes an amount equal to the expense reimbursement fee or break-up fee and also includes a sum such that the bankruptcy estate benefits from the topping bid.

- Provision allowing the stalking horse to match any qualifying bid.
- Provision providing buyer protections to the stalking horse.

Sale Process

Notice Period

After the bid procedures order is entered, notice of the motion to sell and bid procedures order are served on interested parties, including but not limited to potential bidders the Debtor has been in contact with at this point in the process. In approving a sale, the court will want to see that the Debtor has penetrated the market. The Debtor may market the sale by placing advertisements in national or local newspapers or other appropriate forums, such as trade publications.

The court has cautioned Debtors against reducing the notice period to less than 20 days, particularly in sales prior to the filing of a plan and disclosure statement, unless the reduction is absolutely critical to the success of the Sale. *In re Bellwright Industries, Inc.*, Supplemental Order, Case No. 08-1597 (Bankr. D.S.C. Jun. 20, 2008).

Sale Auction and Hearing

If there are qualified competing bids, the court will hold an auction to determine the "highest and best" bid. Bankruptcy courts are given broad flexibility in determining which bid is the highest and best. *In re Georgetown Steel*, Case No. 03-13156 (Bankr. D.S.C. Sept. 15, 2004). In determining which bid is best for the estate, non-cash considerations may be taken into account.

After conducting an auction, if necessary, the court has to approve the sale and consider entering an order authorizing the transfer of assets. In considering approval of the sale, the court will determine whether the sound business purpose test has been met. The following are some of the factors the court may consider when deciding if a sound business reason or emergency exists:

- The amount of time elapsed since filing.
- The Debtor's ability to remain a going concern.
- The likelihood that a plan will be proposed and confirmed in the near future.
- The effect of the proposed distribution on future plans of reorganization.
- The proceeds to be obtained from the sale compared to the appraised value of the assets.
- Whether the asset is increasing or decreasing in value.

In addition to convincing the court that a sound business reason or emergency exists, the sale must also be proposed in good faith; provide adequate notice to interested parties; and the sale price must be fair and reasonable.

Interested parties can object to the sale, in which case the court will conduct a hearing to resolve the objections. Any creditor is a "party in interest" with the right to be heard on any issue arising in the bankruptcy. However, competing bidders generally do not have standing before the Bankruptcy court to object to the procedures for a 363 Sale.[7] Once the sale is approved there is a 14 day stay unless waived by the court.

14 day stay

Federal Rule of Bankruptcy Procedure 6004(h) provides that "[a]n order authorizing the sale, use, or lease of property other than cash collateral is stayed for 14

[7] *See In re Gucci*, 126 F.3d 380, 388 (2d Cir. 1997); however, courts have consistently held that purchasing claims is appropriate even when the goal is merely to create standing. *See, e.g., Hall Fin. Group, Inc. v. DP Partners Ltd. Partnership (In re DP Partners Ltd. Partnership)*, 106 F.3d 667, 670-71 (5th Cir. 1997), *cert. denied*, 522 U.S. 815 (1997); *In re Rook Broad, Inc.*, 154 B.R. 970, 972-74 (Bankr. D. Idaho 1993); *In re First Humanics Corp.*, 124 B.R. 87, 91-92 (Bankr. W.D. Mo. 1991).

days after entry of the order, unless the court orders otherwise." Given the expedited manner of most sales, the debtor will often ask the court to waive the 14 day stay. The court looks for good, adequate and sufficient cause in determining whether to waive the 14 day stay. Also, under Section 363(m), "the reversal or modification on appeal of an authorization under subsection (b) or (c) of this section . . . does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith . . . unless such authorization and such sale or lease were stayed pending appeal."

The *sub rosa* plan objection

The Fifth Circuit case, *Pension Benefit Guar. Corp. v. Braniff Airways, Inc.,*[8] first articulated the *sub rosa* plan doctrine.[9] Other courts have developed synonymous terms such as "creeping plan of reorganization" or "de facto plan." Black's Law Dictionary defines *sub rosa* as "confidential, secret, not for publication."[10] A 363 sale is considered a *sub rosa* plan if it essentially disposes of assets and pays creditors without a formal disclosure statement, written plan, ballot, or meaningful opportunity for creditors to participate in the process.[11]

In *In re Braniff*, the court determined that the transaction would require significant restructuring of the rights of *Braniff* creditors and would have the practical effect of dictating some of the terms of any future reorganization plan. While the *Braniff* court did not explain the appropriate use of a *sub rosa* objection or specify a limitation on

[8] 700 F.2d 935 (5th Cir. 1983).
[9] Rakhee V. Patel and Vickie L. Driver, *Toto, I've a Feeling We're Not in Kansas Anymore: Bankruptcy Sales Outside the Ordinary Course of Business*, The Federal Lawyer, Feb. 2010 at 56.
[10] *Black's Law Dictionary* 1279 (5th ed. 1979).
[11] *See, e.g., In re Dow Corning Corp.*, 192 B.R. 415 (Bankr. E.D. Mich. 1996); *In re Lion Capital Group*, 49 B.R. 163 (Bankr. S.D.N.Y. 1985).

the use of 363 sales, it provided the following, oft-quoted guidance: "the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan sub rosa in connection with a sale of assets."[12]

Advantages of 363 Sales

- The process is flexible.
  - All time periods relating to the sale are subject to modification by the Bankruptcy Court.
    - **Examples include:**
      - Bidding
      - Auctions
      - Notice to interested parties
      - Advertising

- Secured creditors are allowed to credit bid at the auction. (*See* § 363(k)).
- Potential liability for the purchaser is less than if the sale was outside of bankruptcy because of the ability to purchase the assets free and clear of liens.
- Bankruptcy Court approves the transaction.
- Successor liability is avoided.
- The sale is insulated from subsequent challenges.
- The ability to assign contracts and leases.
- The potential to reject executory contracts.

Noteworthy Case Law in South Carolina

(Please visit http://sites.google.com/a/mccarthy-lawfirm.com/bankla-363/ to view relevant court documents for each case.)

Reserve Golf Club of Pawley's Island, LLC, C/A No. 09-09116-jw—The court found that the objecting Committee had no claims against the Debtor. The court considered the Taylor factors satisfied and approved the sale because there were no objections to consider and all other parties supported the sale. However, the court noted the following in a footnote:

> Absent this determination, and the resulting lack of objections, the Court would have concerns regarding a pre-confirmation sale in this case.

[12] *In re Braniff*, 700 F.2d at 940.

> It appears that even without drawing on the previously approved loan of $80,000, the Debtor has funds available and is generating sufficient revenues to operate until a sale by plan could be approved. The proposed purchase price appears significantly less than the scheduled value of the assets. In addition, the evidence raises questions regarding the appropriateness of such a significant expense reimbursement fee for the Buyer considering its longstanding interest in the purchase from Debtor, which thereby raises a question regarding whether the fee was intended to discourage other bidders. However, these concerns are outweighed in this case where all constituents appear to be in agreement with the sale and likely to accept the pending Chapter 11 Plan.

In re Reserve Golf Club of Pawley's Island, LLC, C/A No. 09-09116-jw, slip op. (Bankr. D.S.C. Mar. 23, 2010).

Georgetown Steel Company, LLC, C/A No. 03-13156-jw—The Debtor determined that multiple, qualified bids were submitted and preceded with an Auction. At the conclusion of the Auction, the Debtor declared L&P's final bid as the winning bid on the basis that its cash offer exceeded the cash offer of the stalking horse, ISG. After considering the non-cash components of the ISG bid, the court determined that the ISG bid was the highest and best value for the assets. The creditors also supported the sale to ISG.

Renaissance Park Hotel LLC, C/A No. 06-04893—The original stalking horse, Harbert Real Estate Fund III, LLC, withdrew its offer to purchase the Debtor's assets. Pursuant to the Bidding Procedures Order, Bridgeview, who held a leasehold mortgage on the land and the Hotel, credit bid up to the amount of its debt. The bid included a carve out for administrative expenses of the bankruptcy proceeding and unsecured creditors. A plan of reorganization was confirmed prior to the approval of the sale.

Ducane Gas Grills, Inc., C/A No. 03-15219—At the sale hearing, there was a competitive bidding process between Weber, the stalking horse, and Ullman, the

qualified bidder. Weber made the final successful bid and Ullman's final bid was approved as a "back-up" bid.

Protected Vehicles, Inc., C/A No. 08-00783-dd—The Debtor received a competing bid, but determined that the bid did not comply with the Bid Procedures. The Debtor and the Committee of Unsecured Creditors also determined that the competing bid did not constitute a higher or better offer than the stalking horse's bid. After the auction but before the Sale hearing, the stalking horse increased its offer by one million dollars. At the hearing on the Sale Motion, the competing bidder informed the court that it would not match or exceed the increased offer. The stalking horse purchased the property subject to an ongoing lawsuit.

Pulliam Motor Company d/b/a Pulliam Ford, C/A No. 07-01555-dd—The sale occurred approximately 20 days from filing. The Debtor created a carve out from the sale proceeds to pay unsecured creditors approximately 20%.

StarTrans, Inc., C/A No. 09-07468-dd—This case did not involve any competitive bidding. Numerous secured creditors are involved in this case. Some of the secured assets were sold as part of the sale some were returned to the secured creditors. As a result of the sale, unsecured creditors are expected to receive approximately 20%.

Joe Gibson's Auto World, Inc. d/b/a Joe Gibson's Suzuki, C/A No. 08-04215-hb—The 363 sale was contingent upon the purchaser obtaining approval from the franchisor of Suzuki. Due to the unique circumstances of this case, the disclosure statement and plan were not filed prior to the sale.

Hope Plantation Group, LLC, C/A No. 07-01171-hb—The sale was completed after plan confirmation. In the plan, the Debtor agreed to make payments to the secured

creditor, whose collateral consisted of approximately 66 acres of land. The Debtor agreed to conduct a sale pursuant to section 363 if payments were not made according to the plan. The 363 sale was conducted when the Debtor failed to make the payments as described in the plan. The secured creditor was the only bidder at the Sale hearing and the court accepted its credit bid.

Noteworthy Case Law in other Jurisdictions

***Clear Channel Outdoor, Inc. v. Knupfer*, 391 B.R. 25 (B.A.P. 9th Cir. 2008)**

The Chapter 11 trustee negotiated with DB Burbank, LLC ("DB"), the first priority lienholder on all of the assets, to arrange a sale of the assets pursuant to 363(b). DB served as the stalking horse and credit bid on the assets. There were no qualified overbids at the auction. The bankruptcy court approved the sale free and clear of all liens and found that DB was a good faith purchaser who could rely on the finality of the sale pursuant to Section 363(m). Because the sale was based on a credit bid, there were no proceeds to compensate the junior lienholder, Clear Channel Outdoor, Inc. ("Clear Channel"). Clear Channel appealed the sale order. First, the BAP had to determine if the appeal was moot. The BAP recognized that equitable mootness barred the reversal of the sale but held that neither constitutional, equitable, nor statutory mootness barred a reinstatement of the junior lien. While section 363(m) provides that a sale to a good faith purchaser may not be reversed on appeal, the BAP narrowly construed this provision to apply only to the overall sale under sections 363(b) or (c) but not the specific terms of the sale, specifically the "free and clear" relief under section 363(f). Finding that the appeal was not moot, the BAP then reversed the provision of the sale order that allowed the

transfer free of the junior interest because none of the five elements in section 363(f) were met.

Implications

The lesson from *Clear Channel* is that outside a plan of reorganization, section 363(f) does not permit a secured creditor to credit bid its debt and purchase estate property free and clear of a non-consenting lienholder.

Although the decision came in the context of a credit bid, the Court's reasoning could apply to prevent the sale of property free and clear of a junior lien under section 363(f) in any case where the sale price is less than the amount of the junior lienholder's claim.

If the *Clear Channel* opinion is followed by courts outside of the Ninth Circuit, it could have a dramatic impact on the growing trend of quick 363 sales, especially in small- to mid-size Chapter 11 cases. The opinion also changes the balance of power in a Chapter 11 case, as junior lienholders could have substantial leverage to use "hold-up" tactics to obtain payoffs or other concessions from the senior lienholder and/or the debtor.

***In re Nashville Senior Living*, 407 B.R. 222 (B.A.P. 6th Cir. 2009)**

The Bankruptcy Court approved the sale of properties owned by the debtor and non-debtor co-owners. The Official Committee of Unsecured Creditors, comprised of the non-debtor co-owners, appealed the order granting the Debtors authority to sell the properties. The Committee sought a stay of the order from both the bankruptcy court and the Panel. Both requests were denied and the sale of the properties in question was closed. The Sixth Circuit held that the failure of the Committee to obtain a stay of the order approving the sale of the properties in question prevented the Committee from

pursuing an appeal from that portion of the order authorizing the sale of the non-debtor/co-tenant's interest under section 363(h).

The Committee cited *Clear Channel* for its argument that the Court should apply the "plain meaning" and narrowly interpret 363(m) as applying only to sales under 363(b) or (c) and not to a sale under 363(h). The court disagreed that *Clear Channel* applied. First, *Clear Channel* cited no case law for its conclusion that 363(m) stay does not apply to the "free and clear" aspect of the sale under 363(f). In fact, the Sixth circuit cited several cases to the contrary. The Court also noted that *Clear Channel* ignored a case where the Ninth Circuit had previously applied 363(m) to a "free and clear" sale under 363(f). The court determined that *Clear Channel* was an "aberration in well-settled bankruptcy jurisprudence applying 363(m) to the 'free and clear' aspect of a sale under 363(f)." Second, the court distinguished the facts of *Clear Channel* with the facts in the case before it. In *Clear Channel*, the Panel assumed that relief under section 363(f) was a term of the sale instead of an essential attribute of the validity of the sale. In *Nashville Senior Living*, the court determined that a trustee's ability to sale both the debtors and co-tenants interest under 363(h) was an essential attribute of the sale.

What to do with GM and Chrysler?

Recent, nationally publicized cases such as *In re Chrysler, LLC*[13] and *In re Gen. Motors Corp.*[14] have authorized sales of some or most of very large estate assets under Section 363. At the end of 2009, the Congressional budget bill included an arbitration

[13] 405 B.R. 84 (Bankr. S.D.N.Y. 2009).
[14] 407 B.R. 463 (Bankr. S.D.N.Y. 2009).

provision for terminated GM and Chrysler dealers.[15] Most of the dealerships closed or targeted for closure appealed to an arbitration panel.[16] In March of this year, GM restored franchises to over half of those terminated without completing the arbitration process.[17]

Although these cases are interesting to read and indicative of the public policy impact of 363 sales, neither case will be of much use to practitioners in our district. Unless, of course, the fact pattern replicates itself for a gigantic, multi-billion dollar company in South Carolina.

[15] Chris Shunk, Obama bill signing enacts arbitration process for rejected GM, Chrysler Dealers, Dec. 19, 2009, http://www.autoblog.com/2009/12/19/report-obama-enacts-arbitration-process-for-rejected-gm-chrysl/.
[16] John Crawley, *GM, Chrysler dealers seek arbitration,* Jan. 25, 2010, http://www.reuters.com/article/idUSN2520685120100126.
[17] Zach Gale, *Report: Nearly 600 GM Dealers to be reinstated*, Mar. 5, 2010, http://wot.motortrend.com/6649308/dealers/report-nearly-600-gm-dealers-to-be-reinstated/index.html.

What You Need to Know Before Your Next 363 Sale

Bill McCarthy
Bill Short

11 U.S.C. § 363(b)(1)

- Allows quick approval of the sale of all or substantially all of the debtor's assets.
- Does not require Chapter 11 debtor to file a plan of reorganization before selling its assets.
- However, our district expects a disclosure statement and plan to be filed prior to the 363 hearing.

Pre-Confirmation Sales

- **Sound Business Purpose Test**:
  1. a sound business reason or emergency justifies a pre-confirmation sale;
  2. the sale has been proposed in good faith;
  3. adequate and reasonable notice of the sale has been provided to interested parties; and
  4. the purchase price is fair and reasonable.

  In re Taylor, 198 B.R. 142, 157 (Bkrtcy. D.S.C. 1996).

Mechanics of a 363 Sale

- Stalking Horse-the initial bidder

Stalking Horse

- **Benefits of having a Stalking Horse**:
  - Identifies issues through due diligence
  - Attracts other bidders
  - Provides a floor price at the auction
  - Negotiates an Asset Purchase Agreement, LOI, or a term sheet.
- In exchange, the Stalking Horse receives protections such as a break-up fee or reimbursement fee.

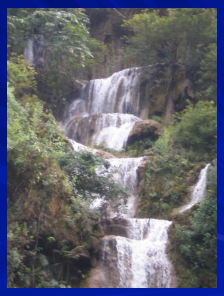
Sale Motion

- Provides a background of the case.
- Includes the terms of the proposed sale.
- Explains why the case meets the elements of the sound business purpose test.
- Addresses how the sale proceeds will be distributed.
- Asks the court to waive the 14-day stay.

Sale Motion

Waterfall Provision

- Shows the levels of payment each class will receive
- If secured creditors are not being paid in full:
  - Debtor needs to obtain their consent and
  - Negotiate a carve out



Mechanics of a 363 Sale

Bidding Procedures

- Purpose: provides formalities and order to the sale process
- Approval:
  - Ex parte v. Notice and a hearing
  - Expedited basis

Motion to Establish Bidding and Other Procedures

- **Solicitation Procedures:**
  - How to qualify potential bidders
  - How to submit bids
- **Auction Procedures:**
  - Date auction will be held
  - Minimum incremental amounts
  - Initial topping bid must exceed the current bid by a certain dollar amount
  - Allow stalking horse to match any qualifying bid
  - Buyer protections to stalking horse

Sale Process

- Notice Period
  - Our district has cautioned against a notice period of less than 20 days.
- Serve sale motion and bid procedures order on interested parties
- Market the sale
- Hold auction if competing qualified bids

Sale Auction and Hearing

- Court must approve the sale
- Some factors in deciding if a sound reason or emergency exists:
  - The amount of time elapsed since filing
  - Debtor's ability to remain a going concern
  - Likelihood a plan will be proposed and confirmed
  - Effect of proposed distribution on future plans
  - Proceeds from sale compared to appraised value of assets
  - Whether the asset is increasing or decreasing in value

14-day Stay

- FRBP 6004(h) provides for a 14 day stay of an order authorizing the sale, use, or lease of property, unless the court orders otherwise
- Typically, the debtor will ask the court to waive the 14 day stay.
- 363(m) provides that a reversal or modification on appeal of an order under 363(b) does not affect the validity of the sale to an entity that purchased the property in good faith unless the sale was stayed pending appeal.

Sub rosa plan objection

- "[T]he Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan sub rosa in connection with the sale of assets."
  - In re Braniff, 700 F.2d 935, 940 (5th Cir. 1983)

Advantages of 363 Sales

- Flexible Process
- Credit bid by Secured Creditor
- Purchase assets free and clear
- Approved by bankruptcy court
- Avoidance of successor liability
- Insulation from subsequent challenges
- Assignment of contracts and leases
- Ability to reject executory contracts

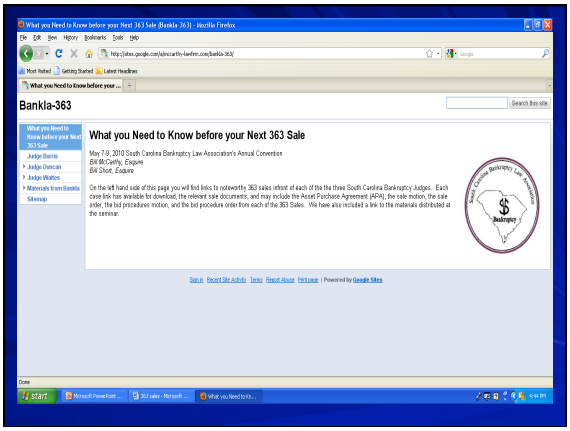
Discussion of South Carolina Case Law

South Carolina Case Law

- http://sites.google.com/a/mccarthy-lawfirm.com/bankla-363/
- The website contains relevant sale documents for noteworthy S.C. cases.

Website

- http://sites.google.com/a/mccarthy-lawfirm.com/bankla-363/



Guidance from the Court

In re Bellwright Industries, Inc., C/A No. 08-01597-JW, Supplemental Order, (Bankr. D.S.C. Jun. 18, 2008).

- Notice must be full and complete and a reduction that is not absolutely critical may not be appropriate.
- Break-up fees should be affirmatively approved in advance of a notice of sale.
- Filing a disclosure statement and plan before a sale better informs all creditors of what to expect in the case.

Noteworthy Case Law

In re Philadelphia Newspapers, LLC, 599 F.3d 298 (3rd Cir. Mar. 22, 2010).

Facts:

- Debtor owns and operates print newspapers and an online publication.
- Filed a Chapter 11 plan to sell substantially all of the debtor's assets at a public auction and that the assets would transfer free of liens.
- The Debtors filed a motion for approval of bid procedures, which sought to preclude the Lenders from "credit bidding" for the assets.

In re Philadelphia Newspapers, LLC

Procedural History:

- Bankruptcy Court: refused to bar the lenders from credit bidding.
  - Reasoning: Any sale of the Debtor's assets required that a secured lender be able to participate by credit bidding its debt.
- District Court: Reversed and held that the Code provides no legal entitlement for secured lenders to credit bid at an auction sale pursuant to a plan.

In re Philadelphia Newspapers, LLC

- **Issue:** What are a secured lender's rights when its collateral is sold pursuant to § 1123(a)(5)(D)?
- No explicit requirements for a "plan sale" under § 1123(a)(5).
- Therefore, the court looks to 1129(b)(2)(A).
- **Holding:** 1129(b)(2)(A) is unambiguous and the plain meaning of the statue permits the Debtor to proceed under subsection (iii) without allowing the Lenders to credit bid.

In re Philadelphia Newspapers, LLC

Analysis:

- The "or" in section 1129(b)(2)(A) is disjunctive and provides three independent circumstances when a plan can be confirmed over the objection of secured creditors.
- 1129(b)(2)(A)(iii) permits confirmation so long as secured lenders are provided "indubitable equivalent" of their secured interest.
  - Subsection (iii) unlike (ii) contains no reference to the right to credit bid created in 363(k).

In re Philadelphia Newspapers, LLC

Dissent:

- Disagreed with the majority's statutory analysis.
- Concluded that the possible cramdown of any plan proposing a sale of a secured lender's collateral can be evaluated only under Section 1129(b)(2)(A)(ii).

Clear Channel Outdoor, Inc. v. Knupfer, 391 B.R. 25 (B.A.P. 9th Cir. 2008)

- Sale based on a credit bid and, therefore, no proceeds to compensate junior lienholder, Clear Channel.
- First, the BAP had to determine if the appeal was moot.
- **Holding**: The appeal was not moot. The court recognized that 363(m) provides that a sale to a good faith purchaser may not be reversed on appeal. However, the court narrowly construed 363(m) to apply to only the overall sale under 363(b) and (c), but not the specific terms of the sale, specifically the relief under section 363(f).

Clear Channel Outdoor, Inc. v. Knupfer, 391 B.R. 25 (B.A.P. 9th Cir. 2008)

- The court then reversed the provision of the sale order that allowed the transfer free of the junior lien interest because section 363(f) was not met.
- **Implications**: Section 363(f) does not permit a secured creditor to credit bid its debt and purchase estate free and clear of a non-consenting junior lienholder.

In re Nashville Senior Living, 407 B.R. 222 (B.A.P. 6th Cir. 2009)

- The Committee comprised of non-debtor, co-owners appealed the sale.
- **Holding**: the failure to obtain a stay of the order prevented the Committee from pursuing an appeal from the order authorizing the sale of the co-owner's interest pursuant to section 363(h).
- The court declined to follow *Clear Channel*
  - *Clear Channel* cited no case law for its conclusion that 363(m) stay did not apply to 363(f).
  - Also distinguished *Clear Channel* on its facts because the sale of the co-owner's interest under 363(h) was an essential attribute of the sale.

Other Cases to Know

- In re Gulf Coast Oil Corp., 404 B.R. 407 (Bkrtcy.S.C.Tex. 2009).
  - 5th Cir. Jurisprudence on 363 sales
  - Goes through an extensive list of factors for a court to consider
- In re On-Site Sourcing, Inc., 412 B.R. 817 (Bkrtcy.E.D.Va. 2009).

Implications of GM and Chrysler?

- Indicative of the public policy impact of 363 sales.
- Not much use to practitioners in South Carolina.