

Sales of Substantially All Assets of Chapter 11 Bankruptcy Estates Outside of a Plan

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Sale formats. A sale of substantially all assets of a Chapter 11 bankruptcy estate can be made pursuant to confirmation of a plan of reorganization or under appropriate circumstances, pursuant to Section 363(b)(1) of the Bankruptcy Code.¹ Confirmation of a plan of reorganization requires that the plan proponent satisfy all of the plan confirmation requirements set forth in Bankruptcy Code Section 1129 after having presented, obtained approval of, and disseminated a disclosure statement and ballots to creditors and equity holders in impaired classes so that they can vote whether to accept or reject the plan.² The plan confirmation process can be lengthy and provides opposing parties with the opportunity to object to approval of the disclosure statement as well as to oppose confirmation of the plan. The plan confirmation process provides creditor protections in the form of disclosure and the opportunity for voting that do not necessarily exist in connection with the sale of property of the estate pursuant to Bankruptcy Code Section 363(b)(1).³

Only the debtor in possession (or trustee if one has been appointed) can sell property of the estate pursuant to Section 363. However, once a debtor in possession's exclusive right to propose a plan of reorganization has terminated, any party in interest may file a plan.⁴ Bankruptcy courts generally approach sales of property of the estate from the premise that the goal is to achieve the greatest value for the estate so that the recovery of creditors and equity holders is maximized.⁵ As a result, open bidding is generally encouraged. However, in transactions presented pursuant to a plan of reorganization, the only opportunity for a competing bid to emerge is through a competing plan (assuming exclusivity is not in effect) or through an objection to confirmation. In contrast, in the context of a sale pursuant to Section 363 there is a greater likelihood, if not a presumption, that the evaluation of the transaction may evolve into an auction where a higher and better offer may prevail. The price may not be the only criteria upon which the new offer is evaluated. It must be a better offer. For example, under certain circumstances a bid for less cash may be considered "higher and better."⁶

Sales of substantially all assets of an estate prior to confirmation of a plan of reorganization. Section 363(b) of the Bankruptcy Code appears on its face to confer upon the bankruptcy judge virtually unfettered discretion to authorize the use, sale or lease, other than in the ordinary course of business, of property of the estate. While the statute requires that notice be given and that the opportunity for a hearing be provided, there is no reference to an "emergency" or "perishability" requirement nor is there an indication that a debtor in possession or a trustee contemplating the sale of property of the estate must show "cause." The language of Section 363(b) is different from the terms of its statutory predecessors which required that there be such a showing.⁷ In order to further the purposes of Chapter 11 reorganization, courts have found that a bankruptcy judge must have substantial freedom to tailor his or her orders to meet differing circumstances and that, therefore, a liberal reading of Section 363(b) is appropriate.⁸ Case law holds that for the debtor to satisfy its fiduciary duty to creditors and equity holders, an articulated business justification is necessary before the sale of an important asset of the debtor's estate outside of the ordinary course of business may be approved.⁹

A strong showing must be made in order to justify the sale of substantially all of the debtor's assets prior to confirmation of a plan of reorganization. Such a sale occurs without the disclosure, solicitation, voting, and confirmation process connected with confirmation of a plan of reorganization. The appeasement of major creditors is not a sufficient justification for the sale of substantially all assets of the estate outside of a plan of reorganization.¹⁰ Courts have identified guidelines to be considered by the bankruptcy judge when presented with a motion for approval of a sale of substantially all of the assets of an estate pursuant to Bankruptcy Code Section 363 prior to confirmation of a plan of reorganization.¹¹

Bankruptcy courts will be inclined not to approve sales under Section 363 which indicate the terms of a plan of reorganization.¹² *In re Braniff Airways, Inc.*, the Fifth Circuit Court of Appeals found that the debtor and 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 the sale of assets.¹³

Many courts have followed the leading case of *In re Lionel Corp.*, 722 F.2d 1063 (2nd Cir. 1983), in holding that a debtor in possession may sell substantially all of the assets of the bankruptcy estate when a sound business reason supports such a sale.¹⁴ Several courts have identified the following four requirements must exist in order to satisfy the "sound business purpose" test: (1) sound business reason; (2) accurate and reasonable notice; (3) adequate price; and (4) good faith.¹⁵ The driving force behind the court's willingness to approve sales of substantially all assets of the estate outside of a plan of reorganization is the desire to maximize the value of the estate.¹⁶

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1. 11 U.S.C. §§1123(b)(4) and 363(b)(1).
 2. 11 U.S.C. §§1129, 1123, 1124, 1125 and 1126.
 3. 11 U.S.C. §§1125, 1126 and 1128.
 4. 11 U.S.C. §1121.
 5. *In re Integrated Resources, Inc.*, 135 B.R. 746, 750 (Bankr. S.D.N.Y. 1992) ("[W]hen a debtor desires to sell an asset, its main responsibility, and the primary concern of the Bankruptcy Court, is the maximization of the value of the asset soldIn general, to receive approval of a proposed sale of assets, the debtor will need to demonstrate to the Bankruptcy Court that proffered purchase price is the highest and best offer. These tenets also apply to the outright purchase of a debtor or its primary assets, as well as the effective acquisition of a debtor through the funding of a plan of reorganization.").
 6. *In re Integrated Resources, Inc.*, 147 B.R. 650, 659 (S.D.N.Y. 1992) (A fundamental principle of bankruptcy law and the debtor's duty with respect to sales of property of the estate is to obtain the highest price or greatest overall benefit possible for the estate.); *In re Financial News Network, Inc.*, 980 F.2d 165, 169-70 (2nd Cir. 1992) (Bankruptcy Courts have broad flexibility in determining which of several bidders should be deemed the successful bidder at a Section 363(b) sales.); *In re After Six, Inc.*, 154 B.R.

876, 882 (Bankr. E.D. Pa. 1993) ("[I]n an appropriate setting, a bankruptcy court . . . could appropriately award a bid to a lower bidder, when that lower bidder had other factors, including even an element as lacking in direct economic impact as 'societal needs,' in its favor. The Bankruptcy Code, like any law, must be read in its context as a tool of mankind, not a body of edicts to which mankind is a slave irrespective of its interests to the contrary . . . It is only in the context of a strong and unusual case to the contrary in which a bankruptcy court should approve a sale to a party which the DIP does not deem the highest and/or best bidder in an auction sale."); *G-K Development Company, Inc. v. Broadmoor Place Investments (In re Broadmoor Place Investments, L.P.)*, 994 F.2d 744, 746 (10th Cir. 1993) (The Bankruptcy Code has the power to disapprove a proposed sale recommended by a trustee or debtor in possession if it has an awareness there is another proposal in hand which, from the estate's point of view, is better or more acceptable.); *In re Summit Corp.*, 891 F.2d 1, 5 (1st Cir. 1989) ("In order to achieve the goals of maximizing the value of the estate and protecting the interests of creditors, the court has plenary power to provide for competitive bidding.").

7. *Committee of Equity Security Holders v. Lionel Corporation (In re Lionel Corp.)*, 727 F.2d 1063, 1069 (2nd Cir. 1983).
8. *Id.*
9. *In re Lionel Corp.*, 722 F.2d at 1069
10. *In re Lionel Corp.*, 722 F.2d at 1070
11. In the leading case of *In re Lionel Corp.*, the Second Circuit Court of Appeals identified the following factors to be considered:

The proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value.

In re Lionel Corp., 722 F.2d at 1071.

12. *Pension Benefit Guaranty Corporation v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F.2d 935, 939-940 (5th Cir. 1983). In the *Braniff* case, the court did not determine whether substantially all assets of the debtor could be sold prior to confirmation of a plan of reorganization. The court found that certain portions of the transactions at issue were clearly outside the scope of Section 363, not only changing the composition of *Braniff's* assets, but also having the practical effect of dictating some of the terms of any future plan of reorganization (the transaction provided for, among other things, the release of claims, the commitment of secured creditors to vote their deficiency claims in favor of any future reorganization plan, and the issuance of \$7.5 million of script entitling the holder to travel on PSA).
13. *In re Braniff Airways, Inc.*, 700 F.2d at 940.
14. *In re Lionel Corp.*, 722 F.2d 1070-1071; *Otto Preminger Films, Ltd. v. Quintex Entertainment, Inc. (In re Quintex Entertainment, Inc.)*, 950 F.2d 1492, 1495 (9th Cir. 1991); *Stephens Industries, Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986); *In re*

Ames Department Stores, Inc., 136 B.R. 357, 359 (Bankr. S.D.N.Y.); *Titusville Country Club v. Penn Bank (In re Titusville Country Club)*, 128 B.R. 396, 399 (Bankr. W.D. Pa. 1991); and *Official Committee of Unsecured Creditors v. LTV Corporation (In re Chateaugay Corp.)*, 973 F.2d 141, 144 (2nd Cir. 1992).

15. *In re Titusville Country Club*, 128 B.R. at 396; *In re Plabell Rubber Products, Inc.*, 149 B.R. 475, 479 (Bankr. N.D. Ohio 1992); *In re Weatherly Frozen Food Group, Inc.*, 149 B.R. 480, 483 (Bankr. N.D. Ohio 1992); *In re Delaware & Hudson Ry. Co.*, 124 B.R. 169 (Bankr. D. Del. 1991); *In re Industrial Valley Refrigeration and Air Conditioning Supplies, Inc.*, 77 B.R. (Bankr. E.D. Pa. 1987).
16. "One of the policies fundamental to the bankruptcy process is that of the Trustee to marshal and maximize estate assets. Section 363(b) fosters that policy by allowing the sale of all, or substantially all, of the debtor's assets outside the context of a plan of reorganization." *In re Ames Dept. Stores, Inc.*, 136 B.R. 357, 359 (Bankr. S.D.N.Y. 1992).