

Demystifying the Bankruptcy Process – Part Three

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By Albena Petrakov

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The COVID-19 pandemic created a lot of turmoil in every industry and every company. From March to September 2020, more than 200 companies in the energy, transportation, entertainment, health & personal care, retail, travel, lodging, and leisure industries cited COVID-19 as a factor in their decision to file for bankruptcy.

The risk of dealing with a company in financial distress was at an all-time high. Understanding the bankruptcy tools available to a company that is on the path to or already in a court-supervised reorganization (known as a Chapter 11 proceeding) can help you manage and reduce this risk.

Chapter 11 filers choose to opt for bankruptcy relief for various reasons: to stop debt collection action, to revise the unworkable capital structure, to address overwhelming litigation, to facilitate the sale of major assets to a prospective buyer, and to reject burdensome contracts, to name a few.

Chapter 11 brings all stakeholders to one forum and facilitates the global resolution of claims and liabilities. It may have a different impact on the different stakeholders and this mini-series will cover the impact of a bankruptcy proceeding on trade creditors, distressed asset buyers, landlords, and the art world. The final summary is intended to help small business owners better understand how valuable a tool Chapter 11 can be during a time of crisis by availing themselves of the new restructuring mechanism for businesses (and individuals with business debt) with undisputed liabilities that do not exceed \$7.5 million.

What If You Are Interested in Buying Assets From A Company In Bankruptcy/Financial Distress

The 2020 market conditions presented opportunities to acquire businesses at relatively good prices. Section 363 of the Bankruptcy Code provides a Chapter 11 debtor the opportunity to sell its assets free and clear of claims, liens, encumbrances, competing ownership interests, and other liabilities that may prevent a sale outside of Chapter 11. As a result, buyers are incentivized by the unique opportunity to purchase distressed assets inside of bankruptcy, especially because the bankruptcy court order approving the sale often expressly forecloses “successor liability” claims against the purchaser.

With a growing number of cases where courts allow a traditional asset buyer (purchasing assets out-of-court) to become liable for the seller’s liabilities, a court-approved sale of all or part of the seller’s assets brings distinct advantages. Another benefit is the ability to cherry-pick favorable contracts and leases, including the ability to take over contracts even if they contain anti-assignment clauses.

The bankruptcy court approval of a 363 Sale takes place in two stages. The first stage entails obtaining court approval of the

bidding protection procedures. These procedures are described in a motion filed with the court. The second stage is the hearing on the sale of the assets itself when the bankruptcy court hears and rules on any objections to the 363 Sale.

Standards for Approving 363 Sale

The standard that the bankruptcy courts generally apply is whether a sound business reason supports the sale. The factors considered in this process include 1) the proportionate value of the assets to the estate as a whole, 2) whether the sale price is fair and reasonable under the circumstances, 3) the amount of time elapsed since the filing, 4) the effect of the proposed distribution on future plans of reorganization, 5) the proceeds to be obtained from the disposition compared to appraisals of the assets, 6) whether the asset is increasing or decreasing in value.

When navigating that process, a company exploring options for buying assets from a bankruptcy estate should consult with bankruptcy counsel to evaluate available tools and establish a strategy.

In case you missed it, read [part one](#), [two](#), [four](#), and [five](#) here.

If you have a question on this topic, please contact [Albena Petrakov](#) at apetrakov@offitkurman.com or 212.380.4106