

PREFACE

As a corporate bankruptcy lawyer I am asked quite often whether practicing bankruptcy law is depressing. The answer is definitely no. Sometimes, even if the questioner is a lawyer, but one who does not practice in the bankruptcy courts, the question is: "What does a bankruptcy lawyer actually do?" Time and patience permitting, my response to that question includes a reference to my representation of clients purchasing an ongoing business out of a bankruptcy proceeding, either through a separate motion to approve the sale or in the context of a plan of reorganization. Representing this type of client in these circumstances is one of my favorite jobs as an attorney, and I hope that an analysis of this subject, full of examples of real life situations, will make an interesting book.

Taking a client through the process of purchasing assets, especially a going concern, out of a bankruptcy proceeding allows a bankruptcy attorney to make use of all aspects of his or her capabilities as a bankruptcy lawyer. Thus the bankruptcy lawyer may have the opportunity to participate in the business decision about whether to purchase the assets and, if so, what form will that purchase transaction take and at what price. This analysis will be re-evaluated throughout the process as the cost of purchasing the assets and the potential purchaser's knowledge about the assets' true value fluctuates.

Throughout the process, counsel to the potential purchaser of assets will be assisting his or her client with the practical (and often exacerbating) aspects of the purchase. I have found no book that adequately discusses the practical issues which will confront a purchaser of assets out of bankruptcy. One simple example of the practical issues that may arise is what to do about the telephone bill. A going concern is sold with bankruptcy court approval and neither the seller/debtor nor the purchaser address the issue of the delinquent phone bill. The purchase is of assets free and clear of liens, claims and encumbrances; however, the phone company requires the delinquent phone bill be paid in full before the purchaser can continue to use the seller's/debtor's telephone number. Maintaining the business's customer base depends, at least in part, on keeping the same phone number. Thus, the purchaser has incurred an unexpected but necessary additional cost for purchasing the assets. It may also be that there is an executory contract (e.g. an advertising agreement) with the telephone company that seller/debtor will need to assume and assign to the purchaser in conjunction with the asset sale. Keeping the same phone number is important to most purchasers of businesses out of bankruptcy, yet it is an issue which attorneys for both the seller and purchaser sometimes forget.

The bankruptcy lawyer may also be required to participate in the initial bidding process on behalf of his or her client. The process will likely be extremely frustrating to the business person who, for the first time, is attempting to purchase an ongoing business out of a bankruptcy. For example, many of the "standard practices" that are used by purchasers of non-debtor companies will not be applicable in the bankruptcy arena. The typical purchaser of a business may have the time to spend many hours performing due diligence to determine the true value of the assets being purchased and to discover any hidden liabilities that may be transferred in the sale. The terms of the purchase offer are often confidential outside of the context of a bankruptcy proceeding, and to the extent other offers are solicited for the purchase, the initial potential purchaser will often be

compensated for the expenditure of time and money performing the due diligence. In a bankruptcy proceeding, however, the potential purchaser of a business may not have the time to perform the same level of due diligence and may not be able to secure adequate reimbursement for the cost of such due diligence if he or she becomes an unsuccessful purchaser. Typically, the purchase offer will not be kept confidential but will, instead, be noticed to many of the debtor's/seller's creditors. A bankruptcy attorney for such a purchaser must make his or her client aware of these distinctions.

The purchase and sale process can often be unpredictable. As the judge waits to approve the sale, there may be multiple bidders on the assets being sold, the bid prices as well as other terms of the offers may change, and, finally, all of this bidding may occur in a hallway of the federal courthouse, without formal rules and outside the bankruptcy court's purview. A bidder that is not selected can easily find fault with the debtor/seller who has just decided to take another bid for less money but without conditions to the sale. Conversely, the successful purchaser of real property may be surprised to find that the typical conditions of a sale were not included in its offer and, therefore, it does not have the opportunity to perform a Phase I environmental audit of the property prior to closing. Even if there is time to have such an audit performed, the purchaser probably will not have any way to avoid the purchase of the assets other than to lose its deposit. Thus, this purchaser may be forced either to accept environmentally tainted property or to forfeit its deposit. The bankruptcy lawyer for this purchaser should have discussed this issue with his or her other client prior to the sale's approval.

Another possible issue which a purchaser of a business out of bankruptcy may face arises where the purchaser has been unable to obtain, either through oversight or lack of money, a covenant not to compete from the individual shareholders of the corporate seller/debtor. In that case, the purchaser may find itself holding an asset worth considerably less than what was anticipated because the value of that business was not analyzed in the context of having a competing business across the street owned by the same individuals who owned the debtor when it operated the business.

These are just a few of the practical issues which may arise in a sale of assets out of bankruptcy. These practical issues will be addressed in this text and set into the broader context of bankruptcy cases generally, the applicable sections of the Bankruptcy Code and Rules, and an analysis of the recent cases dealing with this subject.

Several different hypothetical situations throughout the text will illustrate the application of the legal concepts being discussed. I have included an interview with an actual buyer of a going concern from a bankruptcy estate. Overall, it is my wish to provide not only a helpful legal text, but also a practical, real-world perspective on the complicated legal process of purchasing assets out of a bankruptcy case.