Yesterday's Auctions Today:
363 Sales

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YESTERDAY'S AUCTIONS TODAY: 363 SALES*

I. INTRODUCTION

363 sales are back, or at least discussions as to the potential benefits of using the bankruptcy process to acquire assets from financially distressed sellers are occurring with more frequency these days. In the nineties, most corporate attorneys were very familiar with the basic issues that arise when acquiring assets from financially troubled sellers. The purpose of this outline is to reacquaint old hands from the 1990s with, and to provide a brief primer to the new hands of the 2000s regarding, the basic issues that can arise from acquisitions involving financially distressed companies. These issues arise in two entirely different scenarios: (1) an acquisition of assets from a non-bankrupt entity that is financially troubled or appears likely to become financially troubled, and (2) an acquisition of assets directly from a debtor in possession through a court ordered process under the Bankruptcy Code.[1] Different risks, structures and analyses apply to each of these situations.

It is oftentimes more challenging to overcome the parade of theoretical bankruptcy concerns related to a transaction with a non-bankrupt entity that may in the future become bankrupt after the acquisition has been completed or after the acquisition agreement has been signed, but before it has been closed, than it is to deal with the actual bankruptcy concerns that arise in a transaction with an entity that has actually filed bankruptcy. The protection provided to a buyer in a 363 sale is much greater than can ever be obtained in a transaction outside the bankruptcy process (at least in terms of certainty regarding liabilities). Accordingly, Section II of this outline will address the bankruptcy concerns that need to be overcome in an acquisition of assets from a troubled or distressed seller which the buyer assumes will ultimately become a bankrupt entity. Section III will then describe the means that have been employed to address those concerns. Section IV will address the process that is involved in acquiring assets directly from a bankrupt debtor through the bankruptcy court process (whether through a 363 sale or otherwise) and those bankruptcy concerns which can, or cannot, be overcome by virtue of the comfort of the court order.

II. ACQUIRING ASSETS PRIOR TO A BANKRUPTCY FILING

If a target company is viewed as a likely candidate to file bankruptcy, but has not yet commenced a bankruptcy proceeding, an acquisition of its assets is obviously governed by applicable state corporate law and does not require bankruptcy court approval. However, if the target company begins a bankruptcy proceeding subsequent to such asset sale, the acquisition

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[1] The scope of this outline is limited to sales of assets under chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101 *et seq*. It does not address the sale or transfer of assets under chapters 7, 9, 12 or 13 of the Bankruptcy Code.

could be unwound if a court determines that the transaction was a fraudulent transfer or conveyance.

Similarly, if the target company commences bankruptcy proceedings after the signing but before the closing of the acquisition, the acquisition agreement might be rejected as an "executory contract" or be subject to an assumption process that would inevitably require soliciting other offers to validate the assumption of the agreement as being in the best interests of the debtor's estate.[2]

Further, the purchaser must be aware of the possibility of successor liability. Under state law, the buyer may be held responsible for the seller's liabilities in several situations. The purchaser may attempt to address this potential liability by requiring the target company to indemnify it for any such claims arising from the purchased assets. However, if the target company subsequently files for bankruptcy, the purchaser may not be able to enforce the indemnity and its claim would be treated as that of an unsecured creditor.

A. State Corporate Law Issues

1. Approvals

If the buyer is purchasing assets from a non-bankruptcy seller, the same corporate governance and approval requirements apply as in any asset acquisition. Generally, if the target company is selling all or substantially all of its assets, both the board of directors and a majority of the shareholders must approve the transaction. The complexity of the transaction will increase depending upon the number of shareholders and the terms of the deal (*i.e.*, government and regulatory approvals, financing contingencies, etc.). As will be subsequently discussed, sales in bankruptcy do not require shareholder approval by the selling debtor (or board approval, if a chapter 11 trustee has been appointed). However, most other approvals must be obtained.[3]

2. Fiduciary Duties

When an organization is solvent, a directors' fiduciary duties run to the corporation's shareholders and to the corporation itself, but not to creditors.[4]

Additional concerns arise when it is not clear whether the corporation is solvent, the so-called "zone of insolvency." While courts have not defined the amorphous term "zone of insolvency," generally, it refers to the situation where an organization's financial condition deteriorates to the point where it is at risk of becoming insolvent.[5] Until recently, certain courts,

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[2] The buyer would have a damage claim if the agreement was rejected, but the damages would be limited to the difference between the actual value of the assets and the price the buyer had agreed to pay in the rejected asset acquisition agreement. The buyer would be an unsecured creditor to the extent of those damages. If the damage claim were too high, however, the buyer would effectively lose the damage claim because the proof necessary to establish that damage claim would probably result in the buyer being deemed a recipient of a fraudulent transfer, *i.e.*, the buyer would have proved that the seller had agreed to sell the assets for an amount less than "reasonably equivalent value." *See* discussion *infra* notes 55-59.
[3] The Bankruptcy Code provides certain additional exceptions relating to asset sale approvals (*i.e.*, section 365(f) of the Bankruptcy Code overrides the need to obtain lessor/counterparty consent to transfer certain contracts and leases). *See* discussion *infra* 111-114.
[4] *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007).
[5] *See id.* at 98 (declining to define the zone of insolvency); Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 790 (Del. Ch. 2004) (referring to the zone of insolvency as "some imprecise and hard-to-define vicinity of insolvency").

primarily federal courts, including in Delaware, have held that the fiduciary duties of directors of an insolvent corporation, or one in the zone of insolvency, extend to its creditors.[6] However, as discussed below, the Delaware Supreme Court and the Delaware Chancery Court have recently rejected this line of cases and made clear that directors' and officers' fiduciary duties do not change when the corporation enters the zone of insolvency. Generally the federal courts, and state courts outside of Delaware, will apply Delaware law to breach of fiduciary duty claims against directors of insolvent Delaware corporations.[7]

In 2007, the Delaware Supreme Court clarified the fiduciary duties owed by directors of distressed and insolvent corporations in *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla* ("*Gheewalla*"). The court held that "no direct claim for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency.[8] When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation *for the benefit of its shareholder owners*."[9] Directors owe their fiduciary duties to the corporation and its shareholders, even when the corporation is within the zone of insolvency.[10] "When a corporation is *solvent* those duties may be enforced by its shareholders. . . . When a corporation is *insolvent*, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value. Consequently, the creditors of an *insolvent* corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties. The corporation's insolvency 'makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value."[11] Creditors of insolvent corporations may bring derivative claims on behalf of the corporation. The Delaware Supreme Court, however, has not expressly addressed whether creditors of a corporation operating in the "zone of insolvency" have standing to bring a derivative claim for breach of fiduciary duty.

To plead insolvency, the Delaware Court of Chancery has required a showing that (i) a company's liabilities exceed its assets and there is no reasonable prospect that the business can be successfully continued, or (ii) the company is unable to satisfy its obligations as they become due in the ordinary course of business.[12] These tests are widely acknowledged to lack a bright line quality and are highly factual.

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[6] *See e.g.,* Credit Agricole Indosuez v. Rossiyskiy Kredit Bank, 94 N.Y.2d 541, 550 (N.Y. 2000).

[7] *But see* Stanziale v. Dalmia, (*In re* Allserve Sys. Corp.), 379 B.R. 69, 79 (Bankr. D. N.J. 2007) (applying New Jersey law to a suit brought by a creditor against fiduciaries of a company incorporated in Delaware, where the company operated in New Jersey and the alleged breaches of fiduciary duty occurred there).

[8] In Delaware, shareholders must sue directors derivatively if the alleged injury is suffered by the corporation and the shareholder cannot show that his or her injury is independent of the injury suffered by the corporation. *See* Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1038 (Del. 2004).

[9] *Gheewalla*, 930 A.2d at 101 (emphasis added).

[10] *See id.* at 103. Certain opinions had suggested that when a corporation entered the zone of insolvency, these duties might shift to include creditors, as the potential residual owners of the corporation. Credit Lyonnais Bank Nederland N.V. v. Pathe Commc'ns Corp., 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

[11] *Gheewalla*, 930 A.2d at 102.

[12] *Prod. Res.*, 63 A.2d at 782.

Even when the corporation becomes insolvent, directors continue to owe their fiduciary duties to the corporation, not directly to its creditors.[13] In *Gheewalla*, the court declined to impose on directors direct fiduciary duties to creditors because this would "create a conflict between those directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors."[14] Instead, directors of insolvent corporations "must retain the freedom to engage in vigorous, good faith negotiations with individual creditors for the benefit of the corporation."[15]

Two recent decisions from Delaware, one from the Court of Chancery and the other from the Delaware bankruptcy Court, provide further guidance on the duties owed by and potential liabilities of directors of an insolvent corporation. The most extensive discussion of such duties is by Vice Chancellor Strine in *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.*[16] This case predates *Gheewalla* and was affirmed en banc by the Delaware Supreme Court, which also cited it in *Gheewalla*.[17]

The court in *Trenwick* dismissed breach of fiduciary duty claims by a litigation trust controlled by creditors that were asserted against the directors of a bankrupt specialty insurance company and its wholly-owned subsidiary. The trust alleged that the company had insufficient reserves for the risky insurance it underwrote and made imprudent acquisitions which resulted in the company's bankruptcy; these, and other transactions, were alleged to have been recklessly undertaken when the company was insolvent, or in the zone of insolvency, in dereliction of the directors' duties to creditors. The court categorically rejected the creditor plaintiff's argument that a cause of action exists for deepening insolvency. Even the directors of a near-insolvent corporation may "exercise their business judgment [and] take action that might if it does not pan out result in the firm being painted in a deeper hue of red. The fact that the residual claimants of the firm at that time are creditors does not mean that the directors cannot choose to continue the firm's operation in the hope that they can expand the inadequate pie such that the firm's creditors get a greater recovery."[18]

The court also rejected the creditors' argument that they had standing to pursue direct claims against directors through the litigation trust. Rather, the trust's claim was a derivative one that could only be brought on behalf of the corporation. Therefore, "the Litigation Trust's complaint must be analyzed solely from the perspective of whether it pleads viable claims belonging to Trenwick America itself as an entity."[19] Creditors "of an insolvent firm have no greater right to challenge a disinterested, good-faith business decision than the stockholders of a solvent firm."[20]

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[13] The court did not discuss the specific constituencies to whom fiduciary duties are owed by directors of an insolvent corporation, but in providing for derivative standing for creditors the court indicates that duties are owed to the corporation. *Gheewalla*, 930 A.2d at 103.
[14] *Id*.
[15] *Id*.
[16] 906 A.2d 168, 172 (Del. Ch. 2006), a*ff'd sub nom.*, (Trenwick Am. Litig. Trust v. Billet, 931 A.2d 438 (Del. 2007) (en banc).
[17] *Gheewalla,* 930 A.2d at 99 n. 27.
[18] *Trenwick,* 906 A.2d at 174.
[19] *Id*. at 191.
[20] *Id*. at 195.

Boards of insolvent corporations, like those of solvent corporations, have wide latitude to approve or disapprove corporate transactions. "Delaware law imposes no absolute obligation on the board of a company that is unable to pay its bills to cease operations and liquidate. Even when the company is insolvent, the board may pursue, in good faith, strategies to maximize the value of the firm."[21] Where the corporation is insolvent, a board acting in good faith may pursue a strategy that involves the incurrence of additional debt and does not become a guarantor of the strategy's success. Even in this scenario, "the directors are protected by the business judgment rule. To conclude otherwise would fundamentally transform Delaware law."[22] Directors of distressed or insolvent corporations have the flexibility to consider the consequences of their decisions on each corporate constituency.[23]

While investors were able to breathe a sigh of relief after *Trenwick*, the more recent decision of the Delaware bankruptcy court in *In re The Brown Schools, et al.* added a level of uncertainty.[24] In *The Brown Schools*, the United States Bankruptcy Court for the District of Delaware held that while deepening insolvency is not a separate cause of action, it can be used as a measure of damages for breach of fiduciary duty.[25]

In 1997 and 1998, Defendant McCown De Leeuw & Co., Inc. (hereinafter "MDC") obtained a sixty-five percent share of The Brown Schools for $63 million.[26] The relationship between MDC and The Brown Schools and its related affiliates ("Debtors") was a close one, with MDC providing financial, advisory and consulting services.[27] In addition to the capital and services provided by MDC, the Debtors obtained loans from a number of financial institutions, totaling approximately $100 million.[28] After this debt infusion, the Debtors were able to raise an additional $15 million in financing from Teachers Insurance and Annuity Association of America ("TIAA"). In exchange for the financing, TIAA acquired notes and warrants to purchase shares of stock. Subsequently, MDC loaned the Debtors more money in exchange for unsecured, subordinate debt.[29]

The trouble began in April of 2003 when the Debtors sold off all of their residential treatment centers for $64 million. The proceeds from this sale were used to satisfy the Credit Suisse First Boston debt in full, with the rest going to MDC and the Debtors' financial advisors and counsel. Subsequently, the Debtors were forced to restructure their debt once again.[30] TIAA waived all defaults on the restructured notes and subsequently, MDC and TIAA

[21] *Id.* at 204 (citations omitted).
[22] *Id.* at 205.
[23] *See also Prod. Res.*, 863 A.2d at 788 (interpreting the leading case on director's duties to creditors before *Gheewalla* saying, "[t]he *Credit Lyonnais* decision's holding and spirit clearly emphasized that directors would be protected by the business judgment rule if they, in good faith, pursued a less risky business strategy precisely because they feared that a more risky strategy might render the firm unable to meet its legal obligations to creditors and other constituencies.") (internal citations omitted).
[24] 386 B.R. 37 (Bankr. D. Del. 2008). For a full discussion of this case and its implication for boards of financially troubled companies *see* Michael Weisser and Hayward Majors, *Knee-Deepening Insolvency*, Weil, Gotshal & Manges LLP Private Equity Alert (Aug. 2008), available at www.weil.com.
[25] *See id.* at 48.
[26] *See id.* at 41.
[27] *See id.*
[28] *See id.* at 42.
[29] *See id.*
[30] The Brown Schools had already restructured their debt once in December of 2000. They were forced to sell $32 million in assets and use the money from the sale to reduce the balance of the Credit Suisse First Boston debt.

entered into an intercreditor agreement in which the two parties shared in the proceeds of approximately $25 million in liquidated assets. In March of 2005, the Debtors filed voluntary petitions for relief under Chapter 7 of the Bankruptcy Code.[31] Seventeen months later, the Trustee filed a complaint alleging "breach of fiduciary duty, aiding and abetting breach of fiduciary duty, fraudulent and/or voidable transfers, deepening insolvency, civil conspiracy, and declaratory relief. The Trustee also asserted a separate count of corporate waste against the MDC Defendants and Naples."[32]

Although the Delaware Supreme Court held that there is no independent cause of action for the tort of deepening insolvency in the state of Delaware,[33] *The Brown Schools* court held, in the context of a motion to dismiss, that deepening insolvency can be used as a measure of damages for breach of fiduciary duty if a trustee is able to adequately plead facts supporting elements such as fraud and self-dealing.[34]

Contrary to *The Brown Schools*, the United States Court of Appeals for the Fifth Circuit recently stated its agreement with the Third Circuit's and Delaware Chancery Court's decisions that deepening insolvency is not available as a theory of damages.[35] Likewise, Texas courts have viewed directors' duties to creditors similar to the Delaware decisions. In *Floyd v. Hefner*,[36] for instance, the United States District Court rejected the proposition that when a corporation is in the "zone of insolvency" a director's fiduciary duties shift to creditors.[37]

While the scope of a director's duties in the "zone of insolvency" pre-bankruptcy have been the subject of some potentially confusing judicial precedent, the scope of a director's fiduciary duties once the company is in bankruptcy clearly expand. When a corporation enters chapter 11, it becomes a debtor in possession and is charged with the rights and duties of a trustee and as such has a fiduciary duty to all parties with an interest in the estate, including shareholders and creditors.[38] The fiduciary duties in chapter 11 are still the state law duties of care and loyalty. However, in chapter 11 the duty of care also encompasses the duty to preserve the property of the estate for the benefit of creditors and to refrain from any action that might damage the estate or hinder the reorganization.[39] The duty of loyalty includes maximizing the value of the estate and refraining from engaging in self-dealing or opportunistic behavior.[40] When the interests of various constituencies are in conflict, the debtor in possession is required

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Subsequently, the interest rate on the Credit Suisse debt was raised and MDC poured more money into the Debtors to make up for it. *See id.*

[31] *See id.*

[32] *Id.* at 42-3.

[33] *See* Trenwick Am. Litig. Trust v. Billett, 2007 Del. LEXIS 357, at *1 (Del. 2007), *aff'g*, Trenwick Am. Litig. Trust. v. Ernst & Young, LLP., 906 A.2d 168 (Del. Ch. 2006).

[34] *The Brown Sch.*, 386 B.R. at 53-4.

[35] Wooley v. Faulkner (In re SI Restructuring, Inc.), 532 F.3d 355, 363-4 (5th Cir. 2008).

[36] No. H. 03-5693, 2006 WL 2844245 (S.D. Tex. Sept. 29, 2006.)

[37] *See id.* at * 10; *see also* Medlin v. Wells Fargo, N.A. (In re I.G. Servs., Ltd.), Bankr. LEXIS 3329 at *12 (W.D. Tex. July 31, 2007) (creditors may bring derivative, not direct, claims for breach of fiduciary duties). For a further discussion of Floyd v. Hopkins, *see* Glenn D. West & Emmanuel Obi, *Corporations*, 60 SMU L. REV. 885 (Summer 2007).

[38] *See* Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355-56 (1985).

[39] *See* In re Ionosphere Clubs, Inc., 113 B.R. 164, 169 (Bankr. S.D.N.Y. 1990).

[40] *See Weintraub*, 471 U.S. at 352 (the functions and duties of a debtor-in-possession or a trustee in bankruptcy are closely analogous to management's functions and duties outside of bankruptcy).

to treat each group "fairly" and cannot favor one group without considering the impact on other groups, even if they are lower in priority of payment under the Bankruptcy Code.[41]

In bankruptcy, the debtor's officers and directors may continue to use, sell or lease the corporation's property in the ordinary course of business.[42] They may also pursue transactions outside the ordinary course of business if they get approval from the bankruptcy court.[43] A court will approve non-ordinary course transactions that represent a reasonable exercise of business judgment on the part of the debtor in possession.[44]

Directors and officers of a company in bankruptcy may gain a level of protection from suit when acting within the scope of the debtor in possession's authority and pursuant to a court order.[45] To take advantage of this protection, directors and officers must seek court approval for any transaction out of the ordinary course of business.[46] Furthermore, the Delaware General Corporations Law permits the debtor in possession to take actions carrying out a bankruptcy court order without further action by the directors or shareholders.[47] Such power to act rests with an appointed trustee, designated officers, or a representative appointed by the court.[48]

B. Fraudulent Transfers

Even if the purchaser complies with all of the state law requirements, a court may nonetheless determine that the sale of assets constitutes a fraudulent transfer. Dating from the English Statute of Elizabeth in 1571, fraudulent transfer law prohibits a debtor from transferring its assets to a third party to prevent its creditors from reaching such assets. The modern codifications of fraudulent transfer law are the Uniform Fraudulent Conveyance Act ("UFCA"), the Uniform Fraudulent Transfer Act ("UFTA"), and the Bankruptcy Code. Section 548 of the Bankruptcy Code gives the trustee or debtor in possession the power to avoid fraudulent transfers

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[41] *See id.* at 355; Hall v. Perry (*In re* Cochise College Park, Inc.), 703 F.2d 1339, 1357 (9th Cir. 1983); Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983) (requiring debtor to demonstrate that sale of substantially all of its assets was supported by valid business justification and was not solely a reaction to the desires of the creditors committee).

[42] 11 U.S.C. § 363(c)(1) (2008).

[43] *See id.*

[44] *See e.g.*, The Dai-Ichi Kangyo Bank, Ltd., v. Montgomery Ward Holding Corp. (*In re* Montgomery Ward Holding Corp.), 242 B.R. 147, 153 (D. Del. 1991) (section 363 of the Bankruptcy Code requires that the debtor's decision be supported by a "sound business purpose"). *See also In re* Integrated Res., Inc., 147 B.R. 650, 656 (S.D.N.Y. 1992), *appeal dismissed*, 3 F.3d 49 (2d Cir. 1993) (upholding the application of the business judgment rule in bankruptcy to a board's approval of breakup fees saying, "[c]ourts are loathe to interfere with corporate decisions absent a showing of bad faith, self-interest, or gross negligence.") (*citing* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).

[45] *See e.g.*, Bradford Audio Corp. v. Pious, 392 F.2d 67, 72 (2d Cir. 1968) (granting a court-appointed receiver immunity from liability resulting from carrying out a court order); Pereira v. Foong (In re Ngan Gung Rest.), 254 B.R. 566, 570-71 (Bankr. S.D.N.Y. 2000) ("a trustee is not liable for objectively reasonable mistakes in judgment where discretion is allowed . . . and, when acting in accordance with statutory or other duty or pursuant to court order, he or she is immune from suit for personal liability for such acts.").

[46] *See* Mosser v. Darrow, 341 U.S. 267, 274 (1951).

[47] The statute provides,

> Any corporation of this state, an order for relief with respect to which has been entered pursuant to the Federal Bankruptcy Code . . . may put into effect and carry out any decrees and orders of the court or judge in such bankruptcy proceeding and may take any corporate action provided or directed by such decrees and orders, without further action by its directors or stockholders. . . .

DEL. CODE ANN. tit. 8 § 303(a) (2008).

[48] *Id.*

under the federal bankruptcy law and section 544(b) of the Bankruptcy Code permits the trustee or debtor in possession to avoid fraudulent transfers under state law. Although this outline focuses on the Bankruptcy Code, the underlying state law is important because the trustee or debtor in possession can file claims under state law pursuant to section 544(b). This outline will discuss the Bankruptcy Code provisions and highlight differences with the uniform acts, when applicable.

1. The Bankruptcy Code

Section 548 of the Bankruptcy Code establishes the requirements for fraudulent transfers. The trustee or debtor in possession may avoid transfers made by the debtor with actual or constructive intent within two years of filing for bankruptcy.[49]

a. Actual Fraud

Section 548(a)(1)(A) of the Bankruptcy Code provides for the avoidance of transfers made by a debtor with actual intent to hinder, delay or defraud creditors.[50] It is only necessary to prove one of these three standards. Accordingly, the intent to delay the payment to a creditor, even if the creditor is ultimately paid, satisfies the requirement.

The determination of actual fraud is a question of fact that depends on the circumstances of each case. Since evidence of actual fraud is difficult to obtain, circumstantial evidence is often used to prove intent.[51] Indicia of fraudulent intent, or "badges of fraud," include: (1) lack of or inadequate consideration (2) the parties have a family, friendship or close associate relationship, (3) the transferor retains possession, benefit or use of the property, (4) the party's financial condition before and after the transfer, (5) a pattern or series of transactions or the cumulative effect thereof or a series of transactions or course of dealing after debt is incurred, financial difficulties have arisen or creditors have filed or entered suit, and (6) the general timeline of the questioned events or transactions.[52] Proof of the debtor's insolvency or that fair consideration was not received is not required, but it is considered along with the other factors. The presence of several badges of fraud is conclusive evidence of actual intent unless the debtor can show "significantly clear" evidence of a legitimate supervening purpose.[53]

b. Constructive Fraud

Pursuant to section 548(a)(1)(B) of the Bankruptcy Code, constructive fraud includes any transfer or incurrence of obligation for which the debtor received less than reasonably equivalent value in exchange, plus any one of the following: (1) the debtor was insolvent or became insolvent as a result thereof; (2) the debtor was left with unreasonably small capital to conduct its business after the transfer was made or obligation was incurred; (3) it was intended or anticipated that the debtor would incur debts beyond its ability to pay as they

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[49] This time period may be enlarged to the time period provided under applicable state law pursuant to section 544(b) of the Bankruptcy Code. Thus, if a voidable fraudulent conveyance occurred more than two years prior to the bankruptcy filing, the trustee or debtor in possession may pursue an avoidance action under section 544(b) to obtain the benefit of a longer state law statute of limitations. For example, the statute of limitations under New York law is six years, and under Texas law is four years. N.Y. C.P.L.R. 213(8) (2003); TEX. BUS. & COM. CODE ANN. § 24.010(a) (Vernon 2002).

[50] 11 U.S.C. § 548(a)(1)(A).

[51] Robertson v. Dennis (*In re* Dennis), 330 F.3d 696, 701-02 (5th Cir. 2003).

[52] *Id. See also*, Max Sugarman Funeral Home, Inc. v. A.D.B. Investors, 926 F.2d 1248, 1254 (1st Cir. 1991).

[53] *Id.* at 1254-5.

matured; or (4) the debtor made the transfer or incurred the obligation to or for the benefit of an insider under an employment contract and not in the ordinary course of business.[54]

(i) Reasonably Equivalent Value

The standard of "reasonably equivalent value" in section 548 replaced the former Bankruptcy Act's standard of "fair consideration." Whereas the previous standard required good faith, the current standard does not.[55] The Bankruptcy Code defines value as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor."[56] The Bankruptcy Code does not define "reasonably equivalent value." The determination is a question of fact and depends on the particular circumstances surrounding the transaction.[57] The Third Circuit has utilized a two-part test which examines (1) whether value was received and (2) whether the value was reasonably equivalent under a totality of the circumstances test.[58] Other considerations may include "the fair market value of the property at the time of the sale, the nature of the property in question and its relative marketability, and the number of persons appearing and bidding" on such property.[59]

(ii) Insolvency

The Bankruptcy Code uses a simple balance sheet definition of insolvency whereby the value of the debtor's debts exceeds the value of its assets.[60] However, the definition excludes fraudulently transferred property and exempt property and includes reduced values for contingent assets and liabilities.[61] Insolvency is measured at the time of the transfer, which is determined to be made when the transfer is effective against a subsequent bona fide purchaser under applicable state law.[62] Since a fraudulent transfer does not create the presumption of insolvency, it must be proven, which may be difficult.

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[54] 11 U.S.C. § 548(a)(1)(B).

[55] The UFCA still requires fair consideration and its requirement of good faith. Fair consideration is given "(a) when in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied, or (b) when such property, or obligation is received in good faith to secure a present advance or antecedent debt in amount not disproportionately small as compared with the value of the property, or obligation obtained." UNIF. FRAUDULENT CONVEYANCE ACT § 3, 7A U.L.A. 32 (1999).

[56] 11 U.S.C. § 548(d)(2)(A).

[57] *See* BFP v. Resolution Trust Corp., 511 U.S. 531, 540 (1994) (reasonably equivalent value is not fair market value in a mortgage forclosure). For a discussion of what constitutes reasonably equivalent value, *see, e.g., In re* R.M.L., Inc., 92 F.3d 139 (3d Cir. 1996); Interpool Ltd. v. Patterson, 890 F. Supp. 259 (S.D.N.Y. 1995); *In re* Davis, 169 B.R. 285 (E.D.N.Y. 1994).

[58] *R.M.L.*, 92 F.3d at 152 (totality of circumstances test examines (1) the good faith of the transferee, (2) the fair market value compared to the price paid and (3) whether the transaction was made at arm's length).

[59] *Davis*, 169 B.R. at 299 (quoting *In re* Pruitt, 72 B.R. 436, 445 (Bankr. E.D.N.Y. 1987)).

[60] *See* 11 U.S.C. § 101(32).

[61] The definitions under the UFCA and the UTFA are different from that of the Bankruptcy Code, with the UTFA being more similar. The UFCA provides that "a person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured." UNIF. FRAUDULENT CONVEYANCE ACT § 2(1), 7A U.L.A. 22 (1999). Thus, if a debtor has illiquid assets and short-term debts, it may be insolvent under the UFCA. Under the UTFA, "a debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation" and it is a rebuttable presumption that a debtor is insolvent if he is not generally paying his debts as they become due. UNIF. FRAUDULENT TRANSFER ACT § 2, 7A U.L.A. 289 (1999). *See generally* 5 COLLIER ON BANKRUPTCY, ¶ 548.05[1][a] (15th ed. 2008).

[62] 11 U.S.C. § 548(d)(1).

(iii) Undercapitalization

If the trustee or debtor in possession is unable to prove the debtor's insolvency, then he can try to prove that the debtor was insufficiently capitalized after the transfer. This scenario encompasses situations where the transfer leaves the debtor in a precarious financial situation short of insolvency. Factors may include the debtor constantly being behind in paying its bills or running its business under high financial risk.[63] A debtor continuing its business after a leveraged buyout may fall into this category.[64] This liability basis is very fact-intensive and depends upon a reasonable foreseeability standard, which examines whether the debtor was aware that it would be undercapitalized after the transfer.[65]

(iv) Incurrence of Debt

To prove this element, the trustee or debtor in possession must show that the debtor had the intent to incur debt beyond its ability to pay. Like the determination of actual fraud, determining a debtor's intent may be difficult. Accordingly, courts will also look to indicia of intent for this element.

2. Remedies

The trustee or debtor in possession can receive either the property transferred or the value of such property from the initial transferee.[66] In addition, recovery can include the estate's cost in pursuing the fraudulent transfer litigation. The transferee has a good faith defense under section 548(c) if he gave value and took the property in good faith.[67] If the initial transferee has transferred the property before the avoidance, the trustee or debtor in possession can recover the property or its value from a successor transferee as long as such successor did not take the property for value, in good faith and without knowledge of the voidability of the initial transfer.[68]

C. Executory Contracts

Even if the acquisition agreement passes the fraudulent transfer test, the target company may still be able to avoid its obligations after filing for bankruptcy if the transaction has not closed. The Bankruptcy Code gives debtors the power to reject otherwise enforceable executory contracts.[69] Unlike the fraudulent transfer test, the debtor's right to reject an executory contract does not require the existence of anything unequitable or unjust about the contract. Instead, the Bankruptcy Code generally permits debtors to decline their obligations under any

[63] N.Y. Credit Men's Adjustment Bureau, Inc. v. Adler, 2 B.R. 752, 756 (S.D.N.Y. 1980).
[64] Moody v. Sec. Pac. Bus. Credit, Inc., 971 F.2d 1056, 1073 (3d Cir. 1992) (holding that leveraged buyouts merit close scrutiny under the fraudulent conveyance laws).
[65] *Id.*
[66] 11 U.S.C. § 550(a).
[67] Good faith requires "(1) an honest belief in the propriety of the activities in question; (2) no intent to take unconscionable advantage of others; and (3) no intent to, or knowledge of the fact that the activities in question will hinder, delay, or defraud others" and is not proven by an absence of fraudulent intent. S. Indus., Inc. v. Jeremias, 411 N.Y.S.2d 945, 949 (N.Y. App. Div. 1978).
[68] 11 U.S.C. § 550(b)(1).
[69] 11 U.S.C. § 365(a). For a discussion of the effect of rejection, *see generally* Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding 'Rejection'*, 59 U. COLO. L. REV. 845 (1988) [hereinafter Andrew I]; Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227 (1989); Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1 (1991).

executory contracts that the debtor believes are burdensome or a hindrance to its ability to reorganize.[70]

The scope of this power cannot be overstated. If the target company signs an acquisition agreement with the purchaser and the transaction has not closed before it files for bankruptcy, then the target company may choose not to assume the agreement. If so, the target company is considered to have breached the contract immediately before filing for bankruptcy.[71] The purchaser has a claim for such breach, which has the status of an unsecured claim. Thus, the assets will become part of the bankruptcy estate and the purchaser will become one of many unsecured creditors who might receive only a fraction of their claims.

D. Substantive Consolidation

Substantive consolidation is an equitable doctrine that permits a bankruptcy court to disregard the separateness of related entities and to pool such entities' assets and liabilities.[72] Thus, even if a subsidiary is not an actual party in its parent's bankruptcy, the court may bring the assets and liabilities of such subsidiary into the bankruptcy estate of the parent through the doctrine of substantive consolidation. Since the assets would be consolidated, the claims of the creditors of both the parent and the subsidiary would be pooled against such combined assets.

The fear of substantive consolidation will many times cause a buyer to be concerned that a purchase of assets from an otherwise solvent subsidiary of a potentially insolvent parent may be voided as a fraudulent transfer based on the subsequent bankruptcy of the parent followed by its substantive consolidation with its subsidiary.

E. Successor Liability

The general rule is that an asset purchase only transfers the assets, and not the liabilities, of the seller to the purchaser. However, the purchaser can be held responsible for the seller's liabilities through the doctrine of successor liability, which is an equitable doctrine governed by state law.

Courts traditionally recognize successor liability in the following four situations: (1) the buyer expressly assumes the liabilities; (2) the transaction is a de facto merger or consolidation; (3) the buyer is a mere extension of the seller; or (4) the transaction is merely a fraudulent or collusive attempt to avoid the seller's liabilities.[73] However, some states, including Texas, recognize fewer exceptions to the general rule,[74] while others have recognized two additional exceptions for continuity of enterprise[75] and products liability.[76]

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[70] For a discussion of the standards governing the assume-or-reject election, *see* Andrew I, *supra* note 69, at 895-901.
[71] 11 U.S.C. § 365(g)(1); *Id.* § 502(g).
[72] *See, e.g.*, Fed. Deposit Ins. Corp. v. Colonial Realty Co., 966 F.2d 57, 59 (2d Cir. 1992) (authority for substantive consolidation comes from the bankruptcy court's general equitable powers under § 105 of the Bankruptcy Code).
[73] *In re* Savage Indus., Inc., 43 F.3d 714, 717 n.4 (1st Cir. 1994).
[74] Texas only recognizes the first and fourth exceptions. *See generally* Glenn D. West, *Corporations*, 54 SMU L. REV. 1221, 1238 (2001).
[75] The substantial continuity or continuity of enterprise test imposes liability when one corporation holds itself out as the successor of the prior entity. Factors include whether the companies have the (1) same employees, (2) same supervisors, (3) same production facilities in the same location, (4) production of the same product, (5) same name, (6) continuity of assets, and (7) continuity of general business operations. Since courts usually require that the purchaser be aware that potential claims existed against the seller, a good faith purchaser who takes without notice

A purchaser may attempt to protect itself against potential successor liability claims by providing in the purchase agreement that the selling company must indemnify it for any such claims. However, if the seller subsequently files for bankruptcy, those indemnification obligations may be of limited value.

III. OVERCOMING PRE-BANKRUPTCY CONCERNS

A. Generally

The primary bankruptcy concern in the context of a purchase of assets prior to a bankruptcy filing by a selling entity is the fraudulent transfer concern. No amount of structuring can eliminate this concern as the various steps in the structure may inevitably be "transfers" that could be voided if the fraudulent transfer test is met. However, other than looking for and avoiding "badges of fraud," this concern basically comes down to a question of whether the seller is receiving reasonably equivalent value for the assets being transferred. Since a fraudulent transfer by definition involves a seller who is insolvent or will be rendered insolvent after the purchase, the primary concern is the amount of the purchase price versus the likely valuation of the assets being acquired. Thus, the only way to overcome this bankruptcy concern is to ensure that the buyer has a defensible position that the bargained for price is close to fair market value. It is not any more complicated than that.[77] Obtaining a contemporaneous valuation of the assets by a third party is advisable. Since the target company's board will generally have to justify its decision to sell the assets for the particular price to comply with its fiduciary duties, the valuation information should be available. If the seller will not allow the buyer to actually rely upon the valuation the board obtained, perhaps because the valuation shows the buyer is overpaying, then the buyer should attempt to get a representation that the price paid is "at least" the amount set forth in any recent valuation of the assets obtained by the seller.

The purchaser can become comfortable with successor liability by familiarizing itself with the applicable state law and its recognized exceptions. Successor liability concerns are generally more serious if the purchaser is acquiring an entire product line or continuing business under the trade name of the seller. Even if the purchaser attempts to conduct itself as a new entity, it may still face liability under certain exceptions, such as the product line exception.

B. Ring-Fencing

A significant bankruptcy concern is that the seller will reject the purchase agreement after filing for bankruptcy and prior to closing or that a claim may be made for substantive consolidation. If the seller is a subsidiary of a troubled parent, but is not itself overburdened with liabilities, "ring-fencing" might provide a solution to this problem. By

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of the claims may be protected. Ninth Ave. Remedial Group v. Allis-Chalmers Corp., 195 B.R. 716, 724-28 (N.D. Ind. 1996).

[76] The product line exception imposes liability where the purchaser continues manufacturing the products of the seller under the same trade name. The elements are "(1) the total or virtual extinguishment of tort remedies against the seller as a consequence of an all-asset sale; (2) the buyer's continued manufacture of the same product lines under the same product names; (3) the buyer's continued use of the seller's corporate name or identity, and trading on the seller's good will; and (4) the buyer's representation (*e.g.*, advertising) to the public that it is an ongoing enterprise." *Savage*, 43 F.3d at 717 n.4.

[77] It has also been suggested that it is advisable for the buyer to ensure that the seller utilize the proceeds of the sale to retire the seller's debt or otherwise retain the proceeds for the benefit of the seller instead of repaying debt of an affiliate or distributing the proceeds to stockholders. *See* Corrine Ball & John K. Kane, *A Practical Guide to Distress M&A (Part 1)*, M&A LAW. (Jan. 2003), at 4.

interposing special purpose vehicles in the seller's corporate structure, "ring-fencing" those special purpose vehicles and making the selling entity in the purchase agreement one of the special purpose vehicles (which may require the transaction to be restructured as a stock sale), one can attempt to structure the transaction in such a way that the likely entity to file bankruptcy is not the party to the executory contract, and thus does not have the power to reject it in bankruptcy.

Ring-fencing is designed to establish barriers between the parent and subsidiary to further separate assets or liabilities. For example, if a subsidiary is successfully separated from its parent, a downgrade in the parent's credit rating will not have the same adverse effect on the subsidiary. In the bankruptcy context, a successfully ring-fenced subsidiary will not become a part of the parent's bankruptcy case and its assets and liabilities will not become part of the bankruptcy estate through substantive consolidation. It is important to note, however, that ring-fencing simply further establishes the "separation" between the parent and the subsidiary; it cannot establish the necessary separateness by itself.

Ring-fencing can be achieved by taking actions that evidence the separation and the parent's lack of control over the subsidiary.[78] Actions may include: (1) creating intermediate holding companies between the parent and subsidiary to permit the subsidiary's stock to be pledged to a third party; (2) giving the subsidiary's third party shareholders a so-called "golden" share which requires their consent for a bankruptcy filing; (3) amending the subsidiary's corporate charter to limit its purpose and powers and its ability to assume additional indebtedness; (4) requiring the subsidiary to have an independent director on its board; (5) obtaining a nonconsolidation opinion providing that the assets of the subsidiary will not be consolidated with the parent upon the parent's filing for bankruptcy; and (6) securing comfort that the actions will not be characterized as a fraudulent conveyance and unwound in bankruptcy.[79]

IV. ACQUIRING ASSETS IN BANKRUPTCY

Once the target company files for bankruptcy, the concerns of the purchaser discussed above in Sections II and III largely disappear. Instead, a purchaser acquiring assets from a seller in bankruptcy must overcome a new set of concerns, which are primarily the time and expense involved in getting court approval for such acquisition. In addition, purchasers must still be aware of successor liability.

A. Generally

After a debtor commences a chapter 11 proceeding, it cannot sell or otherwise dispose of its assets outside of the ordinary course of business without court approval. The debtor can obtain such court approval upon a motion[80] and a hearing pursuant to section 363(b) of the Bankruptcy Code[81] or pursuant to a plan under section 1123(a)(5)(D).[82] While a section

[78] Explanations of specific structures are beyond the scope of this outline but will be discussed by the speaker and included in presentation materials.
[79] *See, e.g.*, Peter Rigby, *Protecting Subsidiaries from Parents' Bankruptcies: 'Ring-Fencing' as Practiced During the California Power Crisis*, STANDARDS & POOR, Feb. 2, 2001, *available at* www2.standardsandpoor.com; Tim Reason, *Ring Around the Subsidiary*, CFO: THE MAGAZINE FOR SENIOR FINANCIAL EXECUTIVES, Oct. 2001, at 105.
[80] A motion seeking the authority to sell or lease personally identifiable information under section 363 must include a request for the appointment of a consumer privacy ombudsman. FED. R. BANKR. P. 6004(g).
[81] 11 U.S.C. § 363(b)(1). The Federal Rules of Bankruptcy Procedure impose certain time limitations on the sale of a debtor's assets. For example, except when it is necessary to avoid immediate and irreparable harm, a court cannot

363(b) motion is generally used for the sale of smaller assets, a debtor can sell substantially all of its assets pursuant to a section 363(b) motion if certain requirements are met.

B. Selling Assets Pursuant to Section 363(b) of the Bankruptcy Code

When the proposed use, sale, or lease of property is not in the ordinary course of a debtor's business, the trustee or debtor in possession may only use, sell, or lease such property after notice, hearing and approval of the bankruptcy court.[83] Sales may be conducted by private sale or by public auction.[84] Major asset sales outside of the ordinary course of business may determine issues that may otherwise be determined by a chapter 11 plan. Consequently, bankruptcy courts will carefully scrutinize a sale of assets outside the ordinary course of business before the confirmation of a chapter 11 plan to ensure that such a sale does not represent an attempt by the debtor to evade bankruptcy court requirements for adequate disclosure and plan confirmation.

1. Sales of Substantially All of a Debtor's Assets

Although section 363(b) is designed for smaller asset dispositions, a debtor may sell substantially all of its assets outside of a chapter 11 plan if it proves a "sound business purpose" and meets the other requirements.

a. Sound Business Purpose

The court will approve a sale of substantially all of the assets outside of a chapter 11 plan if the debtor demonstrates that a sound business purpose requires such action. To make this determination, courts examine a number of non-exclusive factors including: (1) the proportionate value of the assets to the estate as a whole, (2) the amount of elapsed time since the filing, (3) the likelihood that a plan of reorganization will be proposed and confirmed in the near future, (4) the effect of the proposed disposition on the future plan of reorganization, (5) the amount of the proceeds to be obtained from the sale versus the appraised value of the assets, and (6) whether the assets are decreasing or increasing in value. The final factor is the most important and may be enough to provide a sound business purpose.[85]

b. Additional Requirements

After establishing a sound business purpose, the debtor must meet three additional requirements: (1) adequate and reasonable notice of the sale must be provided to the interested parties; (2) the purchase price must be adequate, or fair and reasonable, and (3) the sale must be proposed in good faith.[86] Local court rules may require additional disclosures. In Delaware, for example, the debtor must also attach a copy of the proposed purchase agreement and highlight and provide justification and certain disclosures for any provisions relating to a sale to insiders,

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approve an asset sale within the first twenty days after a debtor files for bankruptcy. FED. R. BANKR. P. 6003(b). Similarly, a court order approving an asset sale is stayed for ten days after the entry of the order unless the court orders otherwise. R. 6004(h).

[82] *Id.* § 1123(a)(5)(D) & (b)(4).

[83] *Id.* § 363(b)(1); FED. R. BANKR. P. 6004(f)(1). The "ordinary course of business" standard is not defined so narrowly that changes between prepetition and postpetition activities are *per se* evidence of activities outside of the ordinary course of business. Instead, courts attempt to allow a debtor sufficient flexibility to run its business. *See In re* Johns-Manville Corp., 60 B.R. 612, 617 (Bankr. S.D.N.Y. 1986).

[84] FED. R. BANKR. P. 6004(f).

[85] *In re* Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983).

[86] *See In re* Indus. Valley Refrigeration & Air Conditioning Supplies, Inc., 77 B.R. 15, 21 (Bankr. E.D. Pa. 1987).

agreements with management, releases, private sale without competitive bidding, closing and other deadlines, good faith deposit, interim agreements with proposed buyer, use of proceeds, tax exemption, record retention, sale of avoidance actions, limitations on successor liability, sale free and clear of unexpired leases, credit bids and relief from the stay of the sale order.[87]

(i) Adequate and Reasonable Notice

The notice requirement is guided by due process considerations and is designed to ensure that all interested parties receive notice of the sale. Depending on the circumstances, the requirements may include the terms and conditions of the sale, the time for filing objections and a description of the property.[88] Normally, the court requires at least twenty days notice, although this period can be reduced in certain emergency situations.[89] While notice normally does not have to match that of a disclosure statement required for a reorganization plan, the court may require more stringent requirements for a sale of substantially all of the debtor's assets, such as requiring the notification to "(1) place all parties in interest on notice that Debtor is liquidating its business under Chapter 11; (2) disclose accurately the full terms of the sale, including the identity of the purchaser; (3) explain the effect of the sale as terminating Debtor's ability to continue in business; and (4) explain why the proposed price is reasonable and why the sale before confirmation is in the best interests of the estate."[90]

(ii) Fair and Reasonable Purchase Price

To determine whether this requirement is met, the court will examine evidence such as (1) the solicitation of bids by the trustee or debtor in possession, (2) the negotiations with prospective purchasers, and (3) testimony that the offer accepted was the best offer made for the assets.[91] An auction is often the best evidence of fair value, absent evidence of collusion.[92] It is not necessary to show that the purchase price was the highest possible price obtainable under any circumstances. Although some courts have suggested that a fair and reasonable price must be 75% of the appraised value of the assets, the determination is largely subjective.[93] The court can exercise its discretion and may consider the appraised value, the replacement-cost value, the going-concern value or the liquidation value.[94]

(iii) Good Faith

The debtor may demonstrate good faith by showing that the proposed sale is an arm's length transaction.[95] The court closely scrutinizes transactions with insiders but has the discretion to approve any proposed sale even upon a finding of unfairness or bad faith if the estate is desperate for a buyer.[96] Additionally, prior to filing for bankruptcy, courts may use the good faith standard to prevent a solvent corporation from structuring the sell of all or

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[87] L.R. BANKR. CT. DEL. 6004-1(a) & (b).
[88] FED. R. BANKR. P. 2002(c).
[89] *Id.* 2002; 11 U.S.C. § 102(1)(B).
[90] *In re* Naron & Wagner, Chartered, 88 B.R. 85, 89 (Bankr. D. Md. 1988) (stating that appropriate notice for a preconfirmation sale "should be a functional substitute for the adequate information which would be contained in a disclosure statement concerning the proposed transaction").
[91] *In re* Del. & Hudson Ry. Co., 124 B.R. 169, 179 (D. Del. 1991).
[92] *In re* Abbotts Dairies of Pa., Inc., 788 F.2d 143, 149 (3d Cir. 1986).
[93] *See id.*; *In re* WBQ P'ship, 189 B.R. 97, 104 (Bankr. E.D. Va. 1995).
[94] *WBQ*, 189 B.R. at 104.
[95] *Abbotts*, 788 F.2d at 147 (good faith defined as purchasing in good faith and for value).
[96] *In re* Blue Coal Corp., 168 B.R. 553, 569 (Bankr. M.D. Pa. 1994) (court has discretion to approve sale if "rejection of the offer would be devastating to the creditors").

substantially all of its assets as a bankruptcy sale when the asset sale is being used solely to avoid satisfying stockholder voting requirements.[97]

c. Prohibitions Against Sub-Rosa Plans

Even if the debtor meets the above requirements for selling a substantial asset outside of a chapter 11 plan, some courts will prevent the sale if it effectively establishes essential terms of a plan.[98] Since creditors do not have the opportunity to vote for a section 363(b) sale, the courts may be reluctant to approve sales that appear to bypass the protections for creditors under section 1129 of the Bankruptcy Code.

2. Benefits to Purchasing Assets Pursuant to Section 363(f)

a. Sale Free and Clear of Interests

Purchasers often desire to buy assets from a debtor in bankruptcy because of the court's ability to transfer the assets free and clear of any liens, claims or encumbrances. The interests attach to the proceeds of the sale and the purchaser takes the assets free and clear of such interests.[99] The purchaser may also be protected from claims against the debtor's estate, although the court cannot release all potential successor liability claims relating to the assets.[100] In order to be transferred free and clear, property must meet one of the following five conditions in section 363(f):

(i) Non-Bankruptcy Law Permits Sale Free and Clear of Interests[101]

Since non-bankruptcy law usually does not permit property to be transferred free and clear of another's interests, this section is rarely used. For example, if the property is burdened by a lien, the debtor would have to satisfy the lien before the property could be sold free and clear.

(ii) Entity Holding the Interest in the Property Consents[102]

The notice requirement is designed to ensure that all parties with interests in the property are aware of the pending sale. If the party receives notice and does not file an objection to the sale, then that party's consent to the sale may be implied.[103] The party does not lose its right to payment by the debtor because that right attaches to the proceeds of the sale. However, if the party does not receive proper notice, then there is no consent and the property cannot be sold free and clear of that party's interest.[104]

(iii) Greater Than Aggregate Value of Liens[105]

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[97] *See* Esopus Creek Value LP v. Hauf, 913 A.2d 593, 596, 605-6 (Del. Ch. 2006); *see also* DEL. CODE. ANN. tit. 8, § 271(a) (2008) (requiring a majority of shareholders to approve the sale of all or substantially all of a corporation's property and assets).
[98] *In re* Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983).
[99] *In re* Healthco Int'l, Inc., 174 B.R. 174, 177 (Bankr. D. Mass. 1994); 11 U.S.C. § 361(2).
[100] *See* discussion *infra* Section IV(D).
[101] 11 U.S.C. § 363(f)(1).
[102] *Id.* § 363(f)(2).
[103] *In re* Elliot, 94 B.R. 343, 346-47 (E.D. Pa. 1988); *but see In re* DeCelis, 349 B.R. 465 (Bankr. E.D. Va. 2006).
[104] Folger Adam Sec., Inc. v. Dematteis/Macgregor, JV, 209 F.3d 252, 265 (3d Cir. 2000).
[105] 11 U.S.C. § 363(f)(3).

The property can be transferred free and clear of interests if the purchase price for the property is greater than the aggregate value of all liens on the property. Since the amount of a lien can exceed the value of the property, there is a split of authority over whether the purchase price must exceed the aggregate value of the liens or the value of the property.[106]

(iv) Bona Fide Dispute[107]

Instead of merely alleging the existence of a dispute over the amount of the lien, the debtor must establish an objective basis for either a factual or legal dispute over the validity of the secured debt. It is not necessary for the court to resolve the underlying dispute before approving the transfer.[108]

(v) Money Satisfaction[109]

The property can be transferred free and clear of interests if those interests can be reduced to a claim for money. While most interests can be satisfied by money, several types of equitable relief cannot, such as a federal injunction to clean up an environmental hazard.[110]

b. Assumption and Assignment of Executory Contracts and Unexpired Leases

Notwithstanding any anti-assignment language in contracts and leases, the debtor in bankruptcy may assign such agreements to a third party.[111] Thus, a purchaser of the debtor's assets can decide which of the debtor's agreements in connection with the transferred assets it wishes to assume. The debtor must first assume the contract and cure any defaults under such agreement or provide adequate assurances that such defaults will be promptly cured.[112] The debtor can then assign such contract to the purchaser, provided that the purchaser gives adequate assurances of future performance.[113] Since the assignment relieves the debtor of any further liability under the contract, the other party to the contract will want assurances that the purchaser will be able to perform.[114]

c. Finality of Sale to Good Faith Purchasers

Several provisions of the Bankruptcy Code protect the purchaser of a debtor's assets against claims contesting the validity of such sale. First, a sale under section 363 can be effective immediately upon its issuance.[115] Second, if the purchaser is a good faith purchaser, a reversal or modification on appeal of the section 363(b) sale order will not affect the sale's validity unless the order was stayed pending appeal.[116] However, the sale order must explicitly

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[106] *In re* Collins, 180 B.R. 447, 450 (Bankr. E.D. Va. 1995) (discussing split of authority).
[107] 11 U.S.C. § 363(f)(4).
[108] *Collins*, 180 B.R. at 452.
[109] 11 U.S.C. § 363(f)(5).
[110] *See* discussion *infra* section IV(D)(3).
[111] 11 U.S.C. § 365(f)(1).
[112] *Id.* § 365(b)(1)(A) (with certain exceptions for real property leases).
[113] *Id.* § 365(f)(2)(B). The assignee must give adequate assurance regardless of whether there is a default in such contract or lease.
[114] *Id.* § 365(k). *See generally* 3 COLLIER ON BANKRUPTCY, ¶ 365.08 (15th ed. 2008).
[115] FED. R. BANKR. P. 7062. However, Rule 6004(g) provides that an order authorizing the use, sale, or lease of property is automatically stayed for 10 days unless the court orders otherwise. The parties must ask the court to waive the 10-day period to make the order effective immediately. FED. R. BANKR. P. 6004(g).
[116] 11 U.S.C. § 363(m); *Abbotts*, 788 F.2d at 147.

state that the purchaser is a good faith purchaser to obtain this protection.[117] In determining whether the purchaser is a good faith purchaser, the court examines the conduct of the purchaser. Bad faith may be evidenced by "fraud, collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders" or lucrative offers of continuing employment to insiders of the debtor.[118]

d. Other Benefits[119]

In addition to the primary benefits discussed above, several more advantages should be mentioned. First, since the purchaser will be able to take the assets free and clear of other claims and can selectively assume some, but not all, of the debtor's contracts relating to such assets, the parties will be able to resolve issues that are traditionally the subject of negotiation in acquisitions outside of bankruptcy, such as tax liabilities, litigation and employee obligations. Second, the bankruptcy court order approving the sale normally bars any subsequent claims of fraudulent transfer so the purchaser will not have to fear that the transaction will be unwound. Third, the purchaser may gain certain procedural advantages, such as a reduction of the Hart-Scott-Rodino Act waiting period under a section 363(b) sale.[120] Finally, the bankruptcy court approval can shield directors and officers of the selling bankrupt entity from attacks by shareholders and creditors regarding the price or fairness of the transaction.

3. Structure of the Sale[121]

The debtor's fiduciary duty is to obtain the "highest and best" offer for the assets. The Bankruptcy Code provides that sales may be made by private sale or by public auction.[122] In a private sale, the parties enter into a negotiated agreement that is subject to any higher or better offers. A public auction involves an open bidding process with individualized bidding procedures set by the bankruptcy court for each case. A public auction is normally the preferred structure because of its indicia of fairness. However, the key to any sale pursuant to a section 363(b) order is competitive bidding. The Bankruptcy Code specifically prohibits collusion between potential purchasers, whether the sale is private or public.[123]

a. Negotiating the Initial Offer

Debtors will often identify which of their assets are available for sale, either before or after filing for bankruptcy. The purchaser can conduct due diligence of these assets and determine whether it wants to make a firm offer. If so, the debtor and purchaser will likely enter into a letter of intent or a purchase agreement. The initial offeror can exercise considerable influence over the sale process by conditioning its purchase on the approval of advantageous bidding procedures.

b. Bidding Procedures

Bidding procedures vary according to the particular case and may include the auction date, the assets for sale, a break-up fee, bidding increments and requirements that bidders

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[117] *Abbotts*, 788 F.2d at 149-50.
[118] *Id.* at 147, 149.
[119] *See generally* Ball & Kane, *supra* note 77, at 5-6.
[120] 11 U.S.C. § 363(b)(2)(B) (Hart-Scott-Rodino Act waiting period may be reduced to 15 days).
[121] *See* Goldstein & Waisman, *supra* note *, at 29-34.
[122] FED. R. BANKR. P. 6004(f)(1).
[123] 11 U.S.C. § 363(n). Collusion requires an agreement that controls the sale price and does not merely affect the price. *See* 3 COLLIER ON BANKRUPTCY, ¶ 363.12 (15th ed. 2008).

must meet in order to participate in the auction. Although the court must approve the bidding procedures, it often accepts those proposed by the debtor, which is influenced by the terms of the initial offer.

(i) Potential Advantages

The purchaser may require an early auction date to prevent other potential bidders from conducting enough due diligence to be adequately prepared for the auction. If the purchaser only desires certain assets of the debtor, it can condition subsequent bids on the same asset group, which will discourage potential bidders who do not have the same strategic reasons for the pool of assets. The initial offeror may also require a break-up fee to compensate it for serving as the "stalking horse" for higher and better offers. Bankruptcy courts usually approve reasonable break-up fees as necessary to encourage the bidding process. Similar to break-up fees, topping fees pay the initial offeror a percentage of the amount by which the final bid exceeds the initial offer.[124] The purchaser may also request that subsequent bids be in high increments to discourage potential bidders or may set certain requirements for bidders, such as requiring a deposit, financial statements or demonstration of financial capabilities.

(ii) Notice of Bidding Procedures

After the debtor and initial offeror agree on the bidding procedures, the debtor files a motion with the court to have such procedures approved. Notice of the motion must be provided to interested parties, such as creditors and stockholders, as well as to any known prospective bidders. If the other parties file objections to the proposed bidding procedures, the court will schedule a hearing at which the debtor will have to demonstrate that the proposed procedures are appropriate and designed to maximize the sale price of the assets. After the court approves the procedures, the debtor may have to re-notice the interested parties.

c. Auction Process

Normally, the court sets a deadline for bids. If no additional bids are received, then the debtor will proceed with the initial offer. If competitive bids are received, a formal auction will be held. If the initial offeror is the successful bidder, then the parties will enter into the proposed purchase agreement with the new purchase price. The debtor will file a motion seeking the court's approval of the purchase agreement and must serve notice of the hearing to all interested parties. This motion is often filed contemporaneously with the bidding procedures motion. If another bidder prevails, the debtor and that bidder must enter into a purchase agreement, which is usually similar to the initial offer. After agreeing on the form of the agreement, the debtor will file a motion for court approval and serve notice of the hearing. If a party wishes to object to the sale, it must file a motion seeking a stay of the order approving the sale pending an appeal. Otherwise, the sale may be considered final if the purchaser is found to have acquired the assets in good faith.[125]

4. Break-up Fees

Since the initial offer is subject to higher and better offers, the initial prospective purchaser will often include a break-up fee to compensate it for time and money spent on the

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[124] *See* In re Integrated Res, Inc., 135 B.R. 746, 750 (Bankr. S.D.N.Y. 1992); In re Twenver, Inc., 149 B.R. 954, 955 (Bankr. D. Colo. 1992).

[125] *Id.* § 363(m). The order is automatically stayed for 10 days unless the court grants the parties' request to waive such period. *See* discussion *supra* note 115.

initial offer. Although courts normally apply the business judgment rule to such fees, some courts have subjected break-up fees to stricter scrutiny. In addition, if the initial offeror obtains a break-up fee and is subsequently outbid, then the offeror becomes a creditor of the debtor for the amount of the break-up fee. In order to be guaranteed payment, the initial offeror must have its claim classified as an administrative expense. While most courts recognize the utility of break-up fees, some require the initial offeror to demonstrate that the fee has made a substantial contribution to the estate, such as by inducing a higher and better offer.[126]

a. Business Judgment Test

Courts usually apply the business judgment test and examine whether the debtor's decision to pay a break-up fee is within the debtor's reasonable business judgment. The court would examine whether (1) the relationship between the debtor and prospective purchaser is characterized by self-dealing; (2) the fee hinders competitive bidding; and (3) the amount of the fee is reasonable in comparison to the purchase price.[127] Important factors include: (1) the role of the creditors in negotiating and approving the fee; (2) the reasonableness of the break-up fee in relation to the size and complexity of the sale; and (3) whether the debtor and the purchaser had a "sweetheart" deal.[128]

b. Best Interests of the Estate Test

Recently, some courts have rejected the business judgment test as being inconsistent with the best interests of the estate. The business judgment rule applies to decisions in the ordinary course of business. Since sales pursuant to section 363(b) orders are by definition outside of the ordinary course of the debtor's business, some courts have held that fees for such sales should be subject to strict scrutiny.[129] For example, the Third Circuit specifically rejected the business judgment test and held that the inquiry should be whether the fee was actually necessary to preserve the value of the estate under the standard for administrative expenses.[130] While cases rejecting break-up fees are rare, it is important to note that approval is not automatic.

c. Strategies for Approval of Break-up Fees

Since break-up fees have been subject to increased scrutiny, an initial offeror can increase its chances for approval by establishing that the decision is both within the reasonable business judgment of the debtor and in the best interests of the estate. The prospective purchaser may demonstrate the following: (1) the break-up fee is necessary for a firm offer and does not chill competitive bidding; (2) the amount of the proposed fee is reasonable in relation to the proposed purchase price, size and complexity of the transaction; (3) the fee is only payable if the initial offer is outbid by a higher and better offer; (4) the fee is the product of arm's-length negotiations between the parties; and (5) the creditors and other interested parties approve of the fee as an inducement to obtain competitive bids.[131]

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[126] *In re* S.N.A. Nut Co., 186 B.R. 98, 105 (Bankr. N.D. Ill. 1995).
[127] *Integrated Resources*, 147 B.R. at 657.
[128] *Id.* The lower court decision also discussed (1) the chilling effect of the fee on competitive bidding; (2) whether the fee would exceed fees authorized in other cases and (3) whether other potential purchasers had requested break-up fees. *In re* Integrated Resources, Inc., 135 B.R. 746, 752-53 (Bankr. S.D.N.Y. 1992).
[129] *S.N.A. Nut*, 186 B.R. at 104.
[130] *In re* O'Brien Env't Energy, Inc., 181 F.3d 527, 535 (3d Cir. 1999).
[131] *See* Goldstein & Waisman, *supra* note *, at 70-71.

C. Sale Pursuant to a Chapter 11 Plan

Buying assets pursuant to a plan offers a purchaser the same protections as under a section 363(b) sale. The purchaser can obtain assets free and clear of interests, has the ability to choose which agreements to assume and receives comfort in the finality of the sale. In addition, purchasers may gain a limited exception from the registration requirements of the Securities Act if securities are issued pursuant to a plan.[132] However, a reorganization plan involves much more time and expense than a section 363(b) order.

1. Requirements of a Plan

a. Who Can Propose a Plan

The Bankruptcy Code provides that a debtor may sell substantially all of its assets pursuant to a plan.[133] However, a plan may only be proposed by the debtor, a trustee or debtor in possession or a party in interest, which includes creditors, creditors' committees, shareholders, shareholders' committees and indenture trustees.[134] During the first several months of the case, usually only the debtor can propose a plan.[135]

b. Contents of a Plan

The Bankruptcy Code sets forth specific items that must be included in a chapter 11 plan.[136] For example, it must designate the classes of claims and interests and specify the treatment of impaired classes. The plan must also provide adequate means for its implementation, such as which property will be retained, transferred or sold, whether the debtor will merge with another entity, which defaults will be cured and whether the debtor will issue securities for cash, property, existing securities or in exchange for claims or interests.[137] The plan may include additional items, including whether executory contracts or unexpired leases will be assumed, rejected or assigned.[138]

c. Adequate Notice

Adequate disclosure of the plan must be made to all interested parties so that they can make an informed decision regarding whether to accept or reject it. Pursuant to the Bankruptcy Code, the debtor must distribute to each interested party "the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information."[139] Adequate information is defined as information "that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan."[140]

d. Requirements for Confirmation

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[132] 11 U.S.C. § 1145.
[133] *Id.* § 1123(a)(5)(B) & (D), and (b)(4).
[134] *Id.* §§ 1121, 1109(b).
[135] *Id.* § 1121(b) & (d). Unless the bankruptcy court orders otherwise, the debtor has the exclusive right to file a plan during the first 120 days of the case and the exclusive right to solicit and obtain acceptance of a plan during the first 180 days of the case. These periods may be extended – or reduced – for cause, but any extensions cannot exceed 18 months and 20 months, respectively.
[136] *Id.* § 1123(a).
[137] *Id.* § 1123(a)(5).
[138] *Id.* § 1123(b).
[139] *Id.* § 1125(b).
[140] *Id.* § 1125(a)(1).

(i) Voting

After the disclosure statement is approved by the court and distributed, a vote is taken by the classes of creditors and shareholders. The plan must designate classes of claims and interests, which consist of claims or interests substantially similar to others in the class.[141] If a class is unimpaired, it is conclusively presumed to accept the plan.[142] Conversely, if the plan provides that a particular class will neither receive nor retain any interest in property, the class is deemed to reject the plan.[143] Thus, only impaired classes must vote on the plan. A class of creditors accepts the plan if (1) the holders of at least two-thirds of the amount of claims who actually vote accept the plan and (2) at least one-half of the number of claims within the class who actually vote accept the plan.[144] A class of shareholders accepts the plan if the holders of at least two-thirds of the amount of securities that actually vote accept the plan.[145]

(ii) Confirmation Hearing

After giving notice, the court holds a hearing on the plan at which parties in interest may object to the confirmation of the plan.[146] The plan must meet sixteen criteria for consensual confirmation, including: (1) the plan must be proposed in good faith, (2) the proponent of the plan must have disclosed the identity and affiliation of any individual who will serve as a director, officer or voting trustee of the debtor post-confirmation, (3) each creditor must accept the plan or receive no less than he would receive in a hypothetical liquidation of the debtor, and (4) the plan must be feasible, *i.e.*, financially viable.[147] If the plan is not accepted by a class of creditors or shareholders, it may be confirmed non-consensually or "crammed down" for those rejecting the plan if, among other things, (1) the plan does not discriminate unfairly against the rejecting class; (2) the plan is fair and equitable; and (3) at least one class of impaired creditors or shareholders accepts the plan, not including any acceptance of the plan by an insider.[148] A plan is normally confirmed at least forty-five to sixty days after the plan and disclosure statement are filed. However, the timeframe may be shortened by using a "prepackaged" or "pre-arranged" bankruptcy. In the former, the disclosure statement is prepared and the necessary votes are taken before the debtor files for bankruptcy. In the latter, the terms of the plan are negotiated and agreed to prior to filing, but the votes are not taken until after filing. However, both alternatives require substantial planning and effort by the purchaser.

2. Benefits to Purchasing Pursuant to a Plan

A purchaser may be able to avoid a formal auction if the debtor files the plan within the debtor's exclusive period.[149] In addition, while many section 363(b) sales are for cash, a plan gives the purchaser more flexible financing options. For example, the purchaser can finance a portion of the plan, including its acquisition, by issuing new securities of the reorganized debtor to creditors.[150] A plan also gives the purchaser more flexibility in structuring

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[141] *Id.* § 1123(a)(1).
[142] *Id.* § 1126(f).
[143] *Id.* § 1126(g).
[144] *Id.* § 1126(c).
[145] *Id.* § 1126(d).
[146] *Id.* § 1128.
[147] *Id.* § 1129.
[148] *Id.* §§ 1129(b)(2) & (a)(10).
[149] *Id.* § 1121(b) & (d).
[150] *Id.* § 1123(a)(5)(J).

the acquisition by permitting a merger, stock or asset acquisition.[151] If the target company opposes the transaction, the purchaser can acquire debt or equity securities to influence the process and force the sale. Under a plan, the asset sale may be exempt from certain stamp and similar taxes, which is an exemption not available to a sale of assets under section 363 outside of a plan.[152] Finally, since a plan is designed to permit sales of substantially all of the assets, there may be less resistance than under a section 363 sale.

D. Successor Liability

Although bankruptcy courts can sell assets free and clear of any interests, their ability to cut off successor liability claims is limited. The determination of whether a purchaser can be held responsible for a seller's liabilities involves a two-part analysis: (1) whether state law imposes successor liability[153] and (2) whether the bankruptcy court order cuts off such liability.

Bankruptcy courts have express and equitable powers to sell assets free and clear of any interests, both pursuant to a section 363(b) order and a chapter 11 plan.[154] Although a section 363(f) order may only release interests, some courts are interpreting this language broadly to include more than liens, or *in rem* interests in property.[155] The Third Circuit recently reaffirmed that "the term 'any interest' is intended to refer to obligations that are connected to, or arise from, the property being sold."[156] A broad interpretation permits the bankruptcy court to sell assets free and clear of more interests. However, additional limitations restrict the ability of a purchaser to take such assets free from all claims.

1. Adequate Notice

A bankruptcy court cannot extinguish a claim if a claimant did not receive either actual or constructive notice. The notice must be designed to reach all parties in interest, which includes anyone whose pecuniary interest may be affected by the proposal, in addition to creditors holding claims against the debtor.[157]

2. Future Claims

Future claims involve actions that arise after the conclusion of the bankruptcy proceeding. To determine if the claim can proceed, the court will examine whether the debtor could have reasonably anticipated such claim during the bankruptcy case and whether the debtor expressly provided for it under the chapter 11 plan. If so, the future claimants are enjoined from asserting claims against the debtor or the successor and must look solely to the relief set forth in

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[151] *Id.* § 1123(a)(5)(C).
[152] Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc., No. 07-312, 2008 WL 2404077, *13 (U.S. June 16, 2008).
[153] *See* discussion *supra* notes 73-76.
[154] 11 U.S.C. § 363(f) (authorizing sale of property pursuant to a section 363(b) order "free and clear of any interest in such property"); *Id.* § 1141(c) (authorizing sale of property pursuant to a plan of reorganization "free and clear of all claims and interests"). The bankruptcy court has broad equitable powers under section 105(a), which authorizes it to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." *Id.* § 105(a).
[155] *See In re* Trans World Airlines, Inc., 322 F.3d 283, 289 (3d Cir. 2003) (noting that the "trend seems to be toward a more expansive reading of 'interests in property' which 'encompasses other obligations that may flow from ownership of the property'" (quoting 3 COLLIER ON BANKRUPTCY, ¶ 363.06[1] (15th ed. 2002))); *but see In re* Eveleth Mines, LLC, 312 B.R. 634, 649-55 (D. Minn. 2004) (restricting "interests" to those created under state law).
[156] *Trans World Airlines*, 322 F.3d at 289 (quoting *Folger*, 209 F.3d at 259). The circuit court held that a discrimination settlement and EEOC claims were interests in property and could be extinguished.
[157] *Savage*, 43 F.3d at 720.

the plan. One court has suggested that a debtor could deal with future claims in the plan by (1) appointing a representative for such future claims, (2) filing a proof of claim for such claims, and (3) establishing a trust fund or acquiring insurance to compensate for such claims.[158]

3. Environmental Obligations

Since environmental claims raise special health and safety concerns and are normally governed by state regulations, courts have been reluctant to permit a federal bankruptcy court to completely cut off a debtor's liability.[159] During the bankruptcy proceeding, a debtor must continue to comply with federal and state environmental regulations and such charges are considered administrative claims necessary to maintain the estate.[160] Certain environmental obligations, such as clean-up costs incurred by others, can be discharged because they can be satisfied by money. Other obligations, including an order to stop pollution or to clean up an area, cannot be extinguished because they "run with the land."[161] Even if a bankruptcy court permits an asset sale free and clear of interests, other environmental laws may "trump" this decision and impose liability on the successor.[162]

V. CONCLUSION

This outline is designed to be a general overview of the bankruptcy concerns involved in purchasing assets from financially distressed companies. Each distressed transaction will involve specific and unique issues. But, the bankruptcy-related issues that were so familiar to corporate attorneys in the 1990s must again become familiar to corporate attorneys today.

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[158] *In re* Fairchild Aircraft Corp., 184 B.R. 910, 932-33 (Bankr. W.D. Tex. 1995), *vacated on equitable grounds*, 220 B.R. 909 (Bankr. W.D. Tex. 1998) (discussing claims arising from plane crash occurring after bankruptcy proceeding).

[159] Although the Bankruptcy Code can preempt state laws, the Supreme Court has held that preemption deference must be given to state environmental laws. Midlantic Nat'l Bank v. N.J. Dep't of Env't Prot., 474 U.S. 494, 506-507 (1986) (holding that bankruptcy court cannot authorize abandonment of property under section 554(a) in violation of a state law imposing requirements to protect the public health or safety). *See also In re* Pac. Gas & Elec. Co., 273 B.R. 795, 805 (Bankr. N.D. Cal. 2002) (deference applies to environmental regulation).

[160] *See, e.g.*, 28 U.S.C. § 959(b) (1993) (debtor must operate property "according to the requirements of the valid laws of the State in which such property is situated"); Cumberland Farms, Inc. v. Fla. Dep't of Env't Prot., 116 F.3d 16, 19-20 (1st Cir. 1997) ("abundantly clear that in state-regulated areas such as protection of the environment, a bankruptcy court must comply with the laws of the state involved").

[161] *In re* CMC Heartland, 966 F.2d 1143, 1146 (7th Cir. 1992).

[162] Federal or state law may require the owner of the property to clean-up a contaminated site, regardless of whether it was responsible for the contamination. *See, e.g.*, Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. § 9606(a) (1995) (CERCLA liability). Federal law has also prevented a bankruptcy court from approving a purchase agreement which provided that the purchaser would not assume any environmental liability arising from operations prior to the sale. *See Ninth Ave.*, 195 B.R. at 733 (stating that 42 U.S.C. § 9607(e) prevented such agreement).