

CREDITOR'S RIGHTS TOOLKIT

Should I Care That the Debtor Has Filed a Motion to Sell Its Assets?

Sales pursuant to Section 363 of the Bankruptcy Code have become commonplace in bankruptcy cases as a mechanism to liquidate a debtor's assets and maximize value for creditors. Selling the debtor's assets to a third party provides a new go-forward business partner for the debtor's vendors and customers, and likely provides continuity of jobs for the debtor's former employees. Due to the benefits associated with a sale of the debtor's assets, creditors or parties-in-interest may be under the misconception that they need not pay attention to the sale process. Discussed below are several key reasons that a party should pay attention to the debtor's sale process to ensure that its rights are protected, and its goals achieved.

Key Issues

- **PROTECTING EXECUTORY CONTRACT RIGHTS**

As part of a going-concern sale, the debtor often seeks to assume and assign its executory contracts to the purchaser. An executory contract can only be assumed and assigned if all monetary and nonmonetary defaults are cured. Contract counterparties will want to carefully review the sale papers to determine if their executory contract will be assumed by the purchaser. This is to confirm that they agree with the proposed cure amount (which is the amount required to cure any monetary default) and to timely file an objection if they do not. Additionally, contract counterparties will want to review the sale papers to understand how to obtain adequate assurance of future performance information from the proposed purchaser, since sometimes the bid procedures require contract counterparties to formally request such information. This financial information is important to ensure that the proposed purchaser is ready, willing, able, and has the financial wherewithal to perform under the terms of the contract. For additional information regarding executory contracts, cure claims, and adequate assurance of future performance, please see the following toolkit articles: (i) *What Is an Executory Contract and What Will Happen to My Executory Contract in Bankruptcy?*¹ and (ii) *What Is a Cure Claim and What Does It Mean That the Buyer Has to Provide Adequate Assurance of Future Performance Under My Contract?*²

¹ See [What Is an Executory Contract and What Will Happen to My Executory Contract in Bankruptcy?](#)

² See [What Is a Cure Claim and What Does It Mean That the Buyer Has to Provide Adequate Assurance of Future Performance Under My Contract?](#)

- **SALE OF PREFERENCE CLAIMS**

Section 547 of the Bankruptcy Code allows the debtor, subject to applicable defenses, to claw back funds paid to creditors within 90 days of the bankruptcy being filed (and such lookback period is extended to one year for insiders), claims which are referred to as preference claims. See *How Can You Protect and Defend Your Business From Preference Actions?*³ Preference claims constitute property of the debtor's estate and as such the debtor can sell preference claims as part of a Section 363 sale. Purchasers often want to purchase preference actions to keep the debtor from pursuing their claims, which could alienate parties the purchaser intends to do business with going forward. Even though the purchaser is not the same entity as the debtor, a creditor may not fully understand the legal distinction between the two entities and may take adverse action against the purchaser should it be sued for a preference claim. This could lead to go-forward problems for the new owner. By purchasing preference actions, the purchaser eliminates this potential pitfall. To the extent that a party received payments in the 90-day preference period, understanding the terms of the sale (and the benefit of continuing to do business with the purchaser), might shield a party from having to defend against a preference claim.

- **SALE OF NON-ESTATE PROPERTY**

To the extent that the debtor is holding property belonging to the creditor, the creditor will want to ensure that the sale does not seek to sell such property to the purchaser. Section 363(m) of the Bankruptcy Code limits attacks on a sale order after the sale closes provided the purchaser acted in good faith and without notice of any adverse claims with respect to the assets. To the extent that a creditor has notice of the sale and does not timely act, there is a risk that Section 363(m) will ensure that the purchaser is able to take ownership of the creditor's property.

- **SALES FREE AND CLEAR OF SETOFF RIGHTS**

Setoff rights of nondebtors are treated as secured claims in a bankruptcy case, and a sale motion may propose to sell assets to a buyer, including accounts receivable, free and clear of such rights. If a creditor that holds such setoff rights does not timely object, it could find itself obligated to the buyer for accounts receivable or other claims purchased by the buyer, but unable to assert its setoff rights against the buyer to reduce the amount owed.

- **OBJECTING TO THE SALE TO GAIN LEVERAGE**

Creditors have the right to file an objection both to the bid procedures as well as the terms of any proposed sale. Sometimes a creditor will want to file an objection to try to gain leverage in the bankruptcy case. An example of this occurs where the creditor does or does not want its contract assumed and is using the objection to try to achieve its desired outcome in the case. A party may also object to the sale to put pressure on the debtor to address issues of particular concern to it. By becoming the squeaky wheel, the debtor/purchaser may have an incentive to resolve the party's issues in advance of approval of the sale. Of course, any objection a creditor might file must have a sound legal basis. Whether or not a creditor files an objection, it is important to understand that a debtor need only provide a legitimate business justification for the bankruptcy court to approve its sale.

³ See [How Can You Protect and Defend Your Business From Preference Actions?](#)

Takeaway

A bankruptcy sale can affect a party's rights, so it is important to monitor what is happening in the case and timely respond. Additionally, sometimes a party may want to object to the bid procedures or the underlying sale as a way to get the debtors' attention in a case. As always, it is important to have experienced bankruptcy counsel to help a party navigate the complex bankruptcy issues that can arise in connection with a sale.