CHAPTER 11 ASSET SALES

BY SCOTT D. COUSINS*

ABSTRACT

A debtor, specifically a dot-com company, may liquidate under a Chapter 11 bankruptcy instead of attempting to reorganize. There are several benefits to the company as well as to its creditors under a Chapter 11 liquidation rather than a Chapter 7 liquidation. This article details the concepts, processes and requirements of asset sales in connection with Chapter 11 of the Bankruptcy Code.

I. INTRODUCTION

Although Chapter 11 of the Bankruptcy Code§ is most commonly thought of as a chapter for reorganizations, it is often the case that a troubled company cannot successfully emerge from bankruptcy protection without first selling all or a significant portion of its assets. This type of case is commonly referred to as a "liquidating" case. The Bankruptcy Code provides for the possibility that a Chapter 11 debtor may liquidate while under bankruptcy-court protection. Typically, the sale of assets occurs prior to the confirmation of a liquidating plan of reorganization. Once the assets transfer, Chapter 11 debtors generally have no significant operations

---

*Managing shareholder of the Wilmington, Delaware law office Greenberg Traurig, LLP. The views expressed are solely those of the author and should not be attributed to the author's firm or its clients.


2As noted in other articles in this volume, the majority of dot-com companies, with primarily intangible assets and enormous amounts of debt, may likely sell all or a substantial amount of its assets during a Chapter 11 bankruptcy instead of attempting to reorganize. Dots should be particularly careful when selling personal computers during liquidation, or any other time, because many consumers hunting for computer bargains "are finding all sorts of undeleted surprises," including social security numbers and salaries of employees, payroll information, employee termination letters, extensive minutes from executive and board meetings, and documents outlining strategic plans. Rachel Silverman, Ghost in the Machine: Sold Dot–Com PCS Hold Undeleted Secrets, WALL ST. J., Aug. 20, 2001, at A1.

3The Bankruptcy Code specifically contemplates the confirmation of a plan of reorganization, which effectuates a sale of substantially all of the debtor's assets. 11 U.S.C. § 1123(a)(5)(D) (2000) (A plan of reorganization shall "provide adequate means for the plan's implementation such as [the] . . . sale of all or any part of the property of the estate."); id. § 1123(b)(4) (A plan of reorganization may "provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests.").

835
and instead focus on confirming the plan, liquidating any remaining assets and claims, and eventually dissolving.

There are several benefits for debtors as well as creditors under a Chapter 11 liquidation rather than a Chapter 7 liquidation. First, a Chapter 11 debtor is afforded greater protections including valuable exemptions from transfer taxes and securities registration requirements. The absence of these exemptions could adversely impact the recoveries of creditors and, in certain cases, equity holders. Second, unlike a Chapter 7 case, where the

---

4 In a Chapter 7 case, the Office of the United States Trustee in the district in which the case is pending promptly appoints an interim trustee. 11 U.S.C. § 701(a)(1) (2000); see also 28 U.S.C. § 581(a) (2000) (same). The interim trustee may be replaced by a trustee selected by the unsecured prepetition creditors of the debtor if such creditors who actually vote for the replacement trustee constitute a majority in amount of such claims, provided such amount exceeds twenty percent of all allowable claims that are voted. 11 U.S.C. § 702(c) (2000). Once appointed or elected, the trustee, among other things, takes possession of all non-exempt property of the debtor, liquidates such property and distributes it in accordance with the requirements of the Bankruptcy Code without the necessity of preparing a plan of reorganization and a disclosure statement, soliciting votes in connection therewith and confirming the plan of reorganization. 11 U.S.C. §§ 704, 726 (2000).

5 Section 1146 of the Bankruptcy Code provides that "the making or delivery of instruments of transfer under a plan confirmed under section 1129 of this title" shall be exempt from any stamp taxes. 11 U.S.C. § 1146(c) (2000). This provision has been construed to include transfers under a sale outside of, but in furtherance of effectuating, a plan of reorganization. See In re Hechinger Inv. Co., 254 B.R. 306, 320-21 (Bankr. D. Del. 2000) (holding that a transfer or an instrument of transfer that is essential to or an important component of the plan process, "even if it occurs prior to plan confirmation, 'is under a plan' within the meaning of section 1146(c), subject to an appropriate escrow of funds to cover the tax liability in the event a chapter 11 plan is not confirmed"); see also In re Permar Provisions, Inc., 79 B.R. 530, 533-34 (Bankr. E.D.N.Y. 1987) (holding that a sale of property prior to confirmation was exempt from local taxes because such a sale should have been considered to occur under the plan since a plan could not have been confirmed without a sale); Director of Revenue, State of Del. v. CCA P'ship (In re CCA P'ship), 70 B.R. 696, 698 (Bankr. D. Del. 1987), aff'd, 72 B.R. 765 (D. Del. 1987), aff'd without opinion, 833 F.2d 304 (3d Cir. 1987); accord City of N.Y. v. Smoss Enzers. Corp. (In re Smoss Enzers. Corp.), 54 B.R. 950, 951 (E.D.N.Y. 1985) (finding that a sale taking place three months before confirmation was under a plan, and therefore exempt from transfer tax when the transfer of the property was essential to confirmation of the plan). But see In re NVR, L.P., 189 F.3d 442, 458 (4th Cir. 1999) (restricting section 1146(c) and not exempting transfer taxes prior to actual confirmation of the plan). Moreover, such taxes cannot be assessed against the purchaser of the assets sold by the debtor. In re Cantrup, 53 B.R. 104, 106 (Bankr. D. Colo. 1985). Section 1146(c) has also been held to apply to real estate transfer taxes. In re 995 Fifth Ave. Assocs., L.P., 963 F.2d 503, 511 (2d Cir.), cert. denied, 506 U.S. 947 (1992). Additionally, section 1146(c) does not apply to capital gains on the sale of the debtor's assets. Id. at 513. It should be noted, however, that section 1129(d) provides that "on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of section 5 of the Securities Act of 1933." 11 U.S.C. § 1129(d) (2000).

6 The Bankruptcy Code exempts the original issuance of securities under a plan of reorganization from registration under the Securities Act of 1933, as amended, and state law. 11 U.S.C. § 1145 (2000).
independent trustee is appointed as administrator, the management of a Chapter 11 debtor often retains control as a "debtor-in-possession" throughout a significant portion of the process. The continuation of management presumably is more cost-effective than the appointment of a trustee who is not familiar with the debtor's operations. A Chapter 11 debtor that ceases operations post-confirmation, however, is not entitled to a discharge upon confirming a plan of reorganization. In addition, the liquidating debtor must be aware of the absolute priority rule when distributing the proceeds of the asset sale under a plan of reorganization.

This article will discuss the concepts related to the sale of substantially all of the debtor's assets, the process of asset sales in general and finally, the notice and procedure requirements of asset sales in connection with Chapter 11 of the Bankruptcy Code. To effectively finalize an asset sale in the course of a Chapter 11 bankruptcy, a debtor should adhere to the methods discussed below.

---


8See H.R. REP. NO. 95-595, at 233 (1977) ("[V]ery often the creditors will be benefited by continuation of the debtor in possession both because the expense of a trustee will not be required, and the debtor, who is familiar with the business, will better be able to operate it during the reorganization case.").

9Section 1141(d)(3)(A) states:
The confirmation of a plan does not discharge a debtor if—
(A) the plan provides for the liquidation of all or substantially all of the property of the estate;
(B) the debtor does not engage in business after consummation of the plan; and
(C) the debtor would be denied a discharge under section 727(a) ... if the case were a case under chapter 7 of this title.

10The strict requirement of section 1129(b) of the Bankruptcy Code as to the allocation of full value to the dissenting classes before junior classes can receive a distribution is commonly known as the "absolute priority rule." Because of the requirements that the proponent of a plan of reorganization (often the debtor in possession) must establish to confirm a liquidating plan of reorganization in the event of a "cramdown" contest, a liquidating debtor has no motivation to propose a plan of reorganization that does not strictly adhere to the absolute priority rule. Accordingly, unlike plans of reorganization, liquidating plans usually distribute the remaining assets to creditors and interest holders in the order of their legal priority without a junior class of creditors or interest holders being favored over a more senior class because of the inability to satisfy the new value exception to the absolute priority rule. Since shareholders of a liquidating company have no emerging business in which to reinvest, it is unlikely that the new value exception would be an issue in a Chapter 11 cramdown.
II. SALE OF SUBSTANTIALLY ALL OF THE DEBTOR'S ASSETS

Prior to the enactment of the Bankruptcy Code, most courts required the debtor to demonstrate an emergency to sell substantially all of its assets prior to confirmation of a plan.11 Immediately following its enactment, many courts began recognizing that the Bankruptcy Code would permit the sale of substantially all of the debtor's assets prior to a confirmed plan.12 Some courts, however, still applied the "emergency" test prior to authorizing a debtor to sell substantially all of its assets, even when the debtor was experiencing significant losses that were projected to continue.13

In Committee of Equity Security Holders v. Lionel Corp.,14 the Second Circuit addressed the appropriate standard for approval of a sale of substantially all of the debtor's assets prior to the confirmation of a Chapter 11 plan.15 The Lionel Corp. court adopted the "sound business purpose" or "sound business justification" test.16 As a result of Lionel Corp., many courts began applying the sound business purpose test in lieu of the emergency test.17

---

11 In re Equity Funding Corp. of Am., 492 F.2d 793, 794 (9th Cir.), cert. denied, 419 U.S. 964 (1974) ("Other circuits have recognized the power of the bankruptcy court under Chapter X to authorize a sale of the debtor's property under less than emergency conditions where such sale is necessary to avoid deterioration in the value of the assets."); See also In re Solar Mfg. Corp., 176 F.2d 493, 494 (3d Cir. 1949) (warning that "imminent danger that the assets of the ailing business will be lost if prompt action is not taken").


13 See, e.g., In re Brookfield Clothes, 31 B.R. 978, 981, 986 (S.D.N.Y. 1981) (applying the emergency test to a sale of substantially all of the debtor's assets); In re White Motor Credit Corp., 14 B.R. 584, 590 (Bankr. N.D. Ohio 1981) (finding that a debtor must demonstrate an "emergency").

14 722 F.2d 1063 (2d Cir. 1983).

15 Id. at 1070-71 (holding a sale of Chapter 11 debtor's 82% interest in its subsidiary would have been permissible if the debtor-in-possession could demonstrate a "business justification").

16 See id.

17 See 7 Lawrence P. King, Collier on Bankruptcy ¶ 363.02[4] (15th ed. rev. 1997) (stating that "[i]t is now generally accepted that section 363 allows such sales in chapter 11, provided, however, that the sale proponent demonstrates a good, sound business justification for conducting the sale prior to confirmation"); see also Myers v. Martin (In re Martin), 91 F.3d 389, 395 (3d Cir. 1996) (stating that it would defer to a trustee's judgment so long as there is a legitimate business justification); Official Comm. of Unsecured Creditors v. LTV Corp. (In re Chateaugay Corp.), 973 F.2d 141,145 (2d Cir. 1992) (holding that "the bankruptcy court was within its discretion, based on its consideration of all factors, . . . to determine that a good business reason existed"); Stephens Indus., Inc. v. McClung, 789 F.2d 386, 390 (6th Cir. 1986) (adopting the sound business purpose test); In re Abbotts Dairies of Pa., Inc., 788 F.2d 143, 149 (3d Cir. 1986) (stating that the case should have been remanded to the bankruptcy court for a
Most courts now find that approval of a proposed sale of substantially all of the assets of a debtor outside the ordinary course of business and prior to confirmation of a plan of reorganization is appropriate if the court finds the transaction represents a reasonable business judgment on the part of the debtor. The sound business purpose test requires a debtor to establish four elements: (1) a sound business purpose justifying

finding on whether the assets were purchased "in good faith"); Institutional Creditors of Continental Air Lines, Inc. v. Continental Air Lines, Inc. (In re Continental Air Lines, Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986) (discussing the "articulated business justification" test); In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (Bankr. D. Del. 1999) ("In determining whether to authorize the use, sale or lease of property of the estate under [section 363(b)], courts require the debtor to show that a sound business purpose justified such actions."); In re Delaware & Hudson Ry. Co., 124 B.R. 169, 176, 179 (Bankr. D. Del. 1999) (upholding the bankruptcy court's decision because there were compelling circumstances and a valid business purpose for selling substantially all of the assets and noting the bankruptcy court decisions applying sound business purpose test rather than emergency test); In re Lady H Coal Co., 193 B.R. 233, 241 (Bankr. S.D. W. Va. 1996) (discussing the "fairly and equitably" test); In re Phoenix Steel Corp., 82 B.R. 334, 355-36 (Bankr. D. Del. 1987) (stating that the elements necessary for approval of a section 363 sale in a Chapter 11 case are "that the proposed sale is fair and equitable, that there is good business reason for completing the sale and the transaction in good faith").

18See Martin, 91 F.3d at 395 (stating that where a court is asked to approve the use, sale or lease of property outside of the ordinary course of business, "under normal circumstances the court would defer to the trustee's judgment so long as there is a legitimate business justification"); In re Stroud Ford, Inc., 163 B.R. 730, 732 (Bankr. M.D. Pa. 1993); Titusville Country Club v. Pennbank (In re Titusville Country Club), 128 B.R. 396, 399 (Bankr. W.D. Pa. 1991) (collecting cases authorizing sales outside of a plan and listing criteria for the court to consider in approving such sales); Delaware & Hudson Ry. Co., 124 B.R. at 176 (holding that the following non-exclusive list of factors may be considered by a court in determining whether there is a sound business purpose for an asset sale: "the proportionate value of the asset to the estate as a whole; the amount of elapsed time since the filing; the likelihood that a plan of reorganization will be proposed and confirmed in the near future; the effect of the proposed disposition of [sic] the future plan of reorganization; the amount of proceeds to be obtained from the sale versus appraised values of the property; and whether the asset is decreasing or increasing in value"); Phoenix Steel, 82 B.R. at 335-36 (stating that the elements necessary for approval of a section 363 sale in a Chapter 11 case are "that the proposed sale is fair and equitable, that there is a good business reason for completing the sale and the transaction in good faith") (emphasis added); In re Industrial Valley Refriger. & Air Cond. Supplies, Inc., 77 B.R. 15, 21 (Bankr. E.D. Pa. 1987) (noting the additional requirements—(1) accurate and reasonable notice and (2) adequacy of price paid in the context of a sale of substantially all of a debtor's assets); accord In re Financial News Network, Inc., 980 F.2d 165, 169 (2d Cir. 1992); Gekas v. Pipin (In re Met-L-Wood Corp.), 861 F.2d 1012 (7th Cir. 1988); Stephens Indus., 789 F.2d at 391; Continental Air Lines, 780 F.2d at 1226 (following Lionel); Lionel Corp., 722 F.2d at 1070; In re WBQ P'Ship, 189 B.R. 97, 102 (Bankr. E.D. Va. 1995); In re Crowthers McCall Pattern, Inc., 114 B.R. 877, 886-90 (Bankr. S.D.N.Y. 1990); In re Ionosphere Clubs, Inc., 100 B.R. 670, 673 (Bankr. S.D.N.Y. 1989); In re Coastal Indus., Inc., 63 B.R. 361, 367 (Bankr. N.D. Ohio 1986); see also In re Baldwin United Corp., 43 B.R. 888, 906 (Bankr. S.D. Ohio 1984) (stating that the debtor-in-possession is "required to justify the proposed [transaction] with sound business reasons"); In re St. Petersburg Hotel Assoc., 37 B.R. 341, 343 (Bankr. M.D. Fla. 1983) (stating that section 363 "also implicitly requires the Court to find that it is good business judgment for the Debtor to enter into" the proposed transaction).
the sale of assets outside the ordinary course of business, (2) accurate and reasonable notice provided to interested persons, (3) a fair and reasonable price obtained by the debtor, and (4) a good faith sale without offering lucrative deals to insiders.\(^9\) A sale of substantially all of the debtor's assets prior to confirmation of a Chapter 11 plan will be denied if any of these factors are not established or if the sale contains provisions that are "outside the scope of [section] 363" of the Bankruptcy Code.\(^{20}\) Further, the sale of substantially all of, or a major portion of, the debtor's assets prior to the confirmation of a plan for reorganization does not create a "creeping" or sub rosa plan\(^{21}\) if the sale does not predetermine how the consideration from such sale will be distributed in the prospective plan of reorganization.\(^{22}\)

\(^9\)Abbotts Dairies, 788 F.2d at 147 ("Typically, the misconduct that would destroy a purchaser's good faith status at a judicial sale involves fraud, collusion between purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders"); see also Stephens Indus., 789 F.2d at 390; Lionel Corp., 722 F.2d at 1071; In re Trans World Airlines, Inc., 261 B.R. 103, 121 (Bankr. D. Del. 2001); In re Sovereign Estates, Ltd., 104 B.R. 702, 704 (Bankr. E.D. Pa. 1989) (finding good faith lacking where a proposed settlement agreement benefitted non-debtor insiders); Phoenix Steel Corp., 82 B.R. at 335-36; Indus. Valley, 77 B.R. at 17, 22 (discussing the good faith factor, which "focuses principally on the element of special treatment of the debtor's insiders in the sale transaction and contemporaneous transactions therewith," may be lacking with evidence of inside dealing). Some courts outside of the Third Circuit do not require that the court make a good-faith finding in approving a sale. See, e.g., In re Zinke, 97 B.R. 155, 156 (Bankr. E.D.N.Y. 1989) (noting that while the Abbotts Dairies case requires a good-faith finding, "that duty has not been imposed by the Second Circuit or the United States Supreme Court").

\(^{20}\)Compare Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935 (5th Cir. 1983) (reversing an order approving a sale of significant assets of the estate when the agreement with the purchaser required the secured creditors to vote a portion of their deficiency claims in favor of any reorganization plan approved by a majority of the members of the unsecured creditors committee and provided for a release of all claims by creditors against the debtors, its officers and directors, and its secured creditors) with Delaware & Hudson Ry. Co., 124 B.R. at 178-79 (affirming proposed sale where "shutting down [debtor's business] while preparing a disclosure statement and reorganization plan would result in significant costs to the estate" and would be a "lengthy, complex and litigation filled process").

\(^{21}\)Sub rosa means "[c]onfidential; secret; not for publication." BLACK'S LAW DICTIONARY 1441 (7th ed. 1999).

\(^{22}\)See, e.g., Continental Air Lines, 780 F.2d at 1226 ("When a proposed transaction specifies terms for adopting a reorganization plan, the parties and the district court must scale the hurdles erected in Chapter 11."); Braniff Airways, 700 F.2d at 940 ("The debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan sub rosa in connection with a sale of assets."). See also Order under 11 U.S.C. §§ 105, 363, and 365 Approving (i) Asset Purchase Agreement Between the Debtor, and Consumers Packaging Inc., and Owens-Brockway Glass Container Inc. which Provides for a Sale of Substantially all Assets of the Debtor Free and Clear of Certain Liens, Claims, Interests and Encumbrances, and (ii) Assumption and Assignment of Certain Related Executory Contracts ¶ 9; In re Anchor Resolution Corp., Nos. 96-1434 & 96-1516 (PJW) (Bankr. D. Del., Dec. 20, 1996) (finding by the bankruptcy court that the sale of
III. ASSET SALES

A. "Ordinary Course of Business" Transactions

Generally, a debtor may continue to operate its business and enter transactions in the "ordinary course of business" without court oversight. If, however, a transaction is outside of the ordinary course of business, the bankruptcy court must approve such transaction after notice and a hearing. Even transactions that are not common or that occur occasionally may be deemed ordinary-course transactions. Because the Bankruptcy Code does not define "ordinary course," it may be difficult to determine whether a transaction requires prior court approval.

In determining whether a proposed transaction is in the ordinary course of business, a majority of the courts have adopted both the "horizontal dimension" test and the "vertical dimension" test. Under the horizontal dimension test, the court considers, from an industry-wide perspective, whether the transaction is the sort commonly undertaken by similar businesses in the industry. Nevertheless, the proposed transaction may meet the horizontal dimension test when it "occurs only occasionally" on an industry-wide basis.

Under the vertical dimension test, or the "creditors' expectation" test, the inquiry examines "whether the transaction subjects a creditor to economic risk of a nature different from those he accepted when he decided...

substantially all of the debtor's assets "does not impermissibly restructure the rights of the Debtor's creditors or impermissibly dictate the terms of a liquidating plan of reorganization for the Debtor").


22 Id. § 363(b)(1); In re Roth Am., Inc., 975 F.2d 949, 952 (3d Cir. 1992). Bankruptcy Code section 105 allows the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a) (2000).

23 In re Dant & Russell, Inc., 853 F.2d 700, 704 (9th Cir. 1988) (noting that the "ordinary course" is not defined in the Bankruptcy Code, however, there were guidelines provided by existing case law).

24 Although the term "ordinary course" is used throughout the Bankruptcy Code, 11 U.S.C. §§ 364(a) and 547(c)(2)(B) (2000), it is not defined therein.


27 Dant & Russell, 853 F.2d at 705.
to extend credit."\textsuperscript{30} This test examines the debtor's prepetition practices against its postpetition practices and focuses on whether the transaction "ventures beyond the domain of transactions that a hypothetical creditor would reasonably expect to be undertaken in the circumstances."\textsuperscript{31} The test states that the "ordinariness' of actions taken by a debtor depends on the nature, type and size of the business."\textsuperscript{32} It is inherent in the vertical dimension test that "changes between prepetition and postpetition business activity alone are not \textit{per se} evidence of extraordinariness."\textsuperscript{33} Further, if the contemplated transaction "arose not from the ordinary business events and occurrences, but rather from developments unique to a chapter 11 case," the transaction may be deemed to be outside the debtor's ordinary course of the business under the vertical dimension test.\textsuperscript{34}

If either of these tests is not satisfied, the transaction is outside of the ordinary course of the debtor's business and prior bankruptcy court approval is required before the debtor can engage in the transaction. If, however, prior court authorization is necessary, such as when the transaction is outside of the ordinary course of the debtor's business, the failure to obtain approval may result in the avoidance of the transaction, subject to the good-faith purchaser exception.\textsuperscript{35}

Moreover, if the transaction involves an insider of the debtor, a court will scrutinize these transactions to "ensure that any transaction . . . is fair to the bankruptcy estate and the creditors."\textsuperscript{36} As the Supreme Court has held, officers' and directors' "dealings with the [debtor] corporation are subjected to rigorous scrutiny" requiring the directors to show not only "the good faith of the transaction but also . . . its inherent fairness from the viewpoint of the corporation and those interested therein."\textsuperscript{37} Such insider

\textsuperscript{30}Roth \textit{Am.}, 975 F.2d at 953 (quoting Johns-Manville, 60 B.R. at 616).
\textsuperscript{31}Id. at 954.
\textsuperscript{32}Johns-Manville, 60 B.R. at 617 (stating that the "primary focus of the vertical dimension is thus on the debtor's internal operation and workings"); \textit{see also In re James A. Phillips, Inc.}, 29 B.R. 391, 394 (Bankr. S.D.N.Y. 1983) (stating that ordinariness is the interested parties' reasonable expectations of what transactions the debtor in possession is likely to enter).
\textsuperscript{33}Johns-Manville, 60 B.R. at 617.
\textsuperscript{34}\textit{See, e.g., In re Media Cent., Inc.}, 115 B.R. 119, 125 (Bankr. E.D. Tenn. 1990).
\textsuperscript{35}11 U.S.C. § 549(a) (2000) (authorizing the trustee to avoid unauthorized postpetition transactions).
\textsuperscript{37}Pepper, 308 U.S. at 306. \textit{See also In re Crouse Group, Inc.}, 75 B.R. 553, 557 (Bankr. E.D. Pa. 1987) (stating that fairness is required).
transactions, however, may not require prior court authorization if both the vertical and horizontal dimension tests are satisfied.38

B. Sales Outside of the Ordinary Course of Business

While the sale of assets other than in the ordinary course of business are common, there may be limitations on such sales.39 In fact, one court has declared an outright prohibition of such a sale if not done under a confirmed plan of reorganization.40 Moreover, section 363 of the Bankruptcy Code generally provides for the use, sale, or lease of property on the condition that the debtor provide adequate protection to the holder of an interest in the property that the debtor intends to use, lease, or sell. A debtor has the right to use, sell or lease assets encumbered by another's interests in connection with the operation of its business,41 unless the debtor cannot provide the concerned party in interest in the debtor's property with adequate protection.42

With respect to the debtor's sale of non-cash property that is encumbered by the interests of a third party, generally there is a lack of adequate protection only where the debtor's sale of the property

38 For example, although directors of a debtor Delaware corporation would appear to be "interested" if they vote to increase their retainer or the compensation of the officers who also sit on the board of directors, it would appear that such an increase is not necessarily subject to the bankruptcy court's strict scrutiny or review since the directors are authorized under Delaware law to fix their own compensation and the compensation of the corporation's officers, as long as the increase satisfies the ordinary-course-transaction test. Del. Code Ann. tit. 8, § 141(h) (1974). A bankruptcy court, however, may determine the reasonableness of salaries of regularly employed professionals sua sponte. In re Phoenix Steel Corp., 110 B.R. 141, 143 (Bankr. D. Del. 1989); see also Grant v. George Schumann Tire & Battery Co., 908 F.2d 874, 878 (11th Cir. 1990).

39 See, e.g., Braniff Airways, 700 F.2d at 940 (reversing an order approving a sale of significant assets of the estate when the purchaser required secured creditors to vote a portion of their deficiency claims in favor of any reorganization plan approved by a majority of the members of the unsecured creditors committee and provided for a release of all claims by creditors against the debtor, its officer and directors, and secured creditors). The court found that the sale should not be approved because of the "terms of any future reorganization plan." Id.

40 In re D.M. Christian Co., 7 B.R. 561, 562 (Bankr. N.D. W. Va. 1980) (holding that "a condition precedent to a liquidating plan is the preparation of a written disclosure statement, approval of same by the Court, and the transmittal of the same to the creditors").


"unjustifiably jeopardizes" the non-debtor party's property interest. In determining whether the sale of such assets unjustifiably jeopardizes another entity's interest in the property, courts have considered: (1) the likelihood of reorganization and (2) the necessity of the property to the reorganization. Thus, where the debtor's use of property in which another asserts an interest is critical to the probability of a successful reorganization, courts often allow the sale of such property, thereby interpreting the adequate protection requirements of section 363(e) broadly. Indeed, the legislative history suggests that having the liens of a secured creditor attached to the proceeds of a sale will adequately protect the creditor's interest. Section 363(e) of the Bankruptcy Code provides that, "on request of an entity that has an interest in property used . . . by the trustee [(or debtor in possession)], the court, with or without a hearing, shall prohibit or condition such use . . . as is necessary to provide adequate protection of such interest." The Bankruptcy Code specifically contemplates the sale of estate property free and clear of all liens. For example, section 363(f) of the Code permits a sale of estate assets "free and clear" of all liens, claims and encumbrances that attach to the net proceeds of the sale. Additionally,

43In re Aqua Assoc., 123 B.R. 192, 196 (Bankr. E.D. Pa. 1991) (stating that the important question in determining adequate protection, notwithstanding the type of security interest, is whether the interest is "unjustifiably jeopardized"); In re Grant Broad. of Phila., Inc., 71 B.R. 376, 386-87 (Bankr. E.D. Pa. 1987), aff'd, 75 B.R. 819 (E.D. Pa. 1987).

44See Grant Broad., 71 B.R. at 386-87; see also In re Hunnington Group, Inc., 125 B.R. 739, 741 (Bankr. N.D. Tex. 1990) (entitling the debtor to use the proceeds from a sale as long as the debtor provides adequate protection to the creditor). This factor is often addressed, as adequate protection cases arise, in the context of a creditor's motion to lift the automatic stay with respect to its property. Under section 362(d)(2)(B) of the Bankruptcy Code, a debtor must demonstrate that the property is necessary to an effective reorganization to prevent such motions from being granted. 11 U.S.C. § 362(d)(2)(B) (2000).

45Grant Broad., 71 B.R. at 387 (approving use of property over the objections of secured note holders where the debtor's use of cash collateral would enable it to reorganize); see also In re Pursuit Athletic Footwear, Inc., 193 B.R. 713, 720-21 (Bankr. D. Del. 1996).


4811 U.S.C. § 363(e) (2000). Section 363(e) also "applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362)." Id.

49Section 363(f) provides:
The trustee may sell property under section (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—
(1) applicable nonbankruptcy law permits sale of such property free and clear of any interest;
(2) such entity consents;
(3) such interest is a lien and the price at which such property is to be sold is
section 1123(a)(5)(D) provides for the sale of property free and clear of liens in connection with the confirmation of a Chapter 11 plan. Section 1123(b)(4) contemplates confirmation of a liquidating plan, whereby the debtor sells all of the property under a confirmed plan of reorganization. Moreover, most courts provide a purchaser of a debtor's assets with protection from the claims of the debtor's creditors provided such holders have actual or constructive notice of the bankruptcy proceeding.  

IV. NOTICE AND PROCEDURE

The approval of a sale of the estate's assets is sought by filing a motion. Bankruptcy Rule 2002 generally requires that "the debtor, the trustee, all creditors and indenture trustees" receive at least "20 days' notice by mail of...a proposed use, sale, or lease of property of the estate other than in the ordinary course of business." Additionally, notice should be provided to the office of the U.S. Trustee, to any official committee or its counsel, to the debtor if a trustee has been appointed and to equity security holders (in the case of the sale of substantially all of the debtors assets). Notice should also be provided to creditors and equity security holders.

greater than the aggregate value of all liens on such property;
(4) such interest is in bona fide dispute; or
(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Id. § 363(f); see also Fogal v. Zell, 221 F.3d 955, 965 (7th Cir. 2000) (stating that under 363(f), assets of a debtor can be sold free and clear of any liens); Chicago Truck Drivers, Helpers & Warehouse Workers Union (Independent) Pension Fund v. Tasemkin, Inc., 59 F.3d 48, 50 (7th Cir. 1995) (finding that under section 363(f), a trustee sale can be made free and clear of existing interests); In re Elliot, 94 B.R. 343, 345 (E.D. Pa. 1988) (holding that section 363(f) is written in the disjunctive: the court may approve sale "free and clear" provided at least one of the subsections is met).


31FED. R. BANKR. P. 9014.

32Id. at 2002(a)(2), 9034(a).

33Id. at 2002(f)(k).

34Id. at 2002(d)(3). The court may, however, limit or eliminate notice to equity security holders. Id.
holders who have entered their appearance in the case,\textsuperscript{35} to certain government agencies\textsuperscript{36} and if approval under section 7A of the Clayton Act\textsuperscript{37} is required, to the "Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice."\textsuperscript{38} The twenty-day notice period may be shortened and the method of notice may be modified if the court so orders.\textsuperscript{39} The notice to be served may also be limited to exclude a mailing to all creditors and equity security holders who have not entered an appearance in the case.\textsuperscript{40} Due process, however, requires that such notice must actually be served on any creditor with an interest in the property to be sold, including any lien holders, taxing authorities and leasehold interest holders who are affected by the sale, and any governmental agencies (such as environmental agencies) with jurisdiction over the property to be sold.\textsuperscript{61} In addition to those parties in interest who have entered an appearance in the case, notice of the sale of the debtor's assets outside the ordinary course of business should be

\begin{itemize}
\item \textsuperscript{35} Fed. R. Bankr. P. 6004(a); see id. at 2002(i), (k) & 9034(a). It is important to note, however, that the failure of counsel for a creditor to file notice of appearance may be a basis for dismissing an appeal where that creditor seeks to overturn a sale for which it did not receive notice. Southern Ry. v. Johnson Bronze Co., 758 F.2d 137, 140-41 (3d Cir. 1985).
\item \textsuperscript{36} Fed. R. Bankr. P. 2002(j).
\item \textsuperscript{39} 11 U.S.C. § 363(b)(2)(B); see also Fed. R. Bankr. P. 9007 (authorizing the court to regulate the forms of notice); id. at 9006(c) (providing that the court may, in its discretion, reduce a period provided under certain Bankruptcy Rules "for cause shown . . . with or without motion or notice order").
\item \textsuperscript{40} Fed. R. Bankr. P. 2002(j). See also Southern Ry. v. Johnson Bronze Co., 758 F.2d 137, 141 (3d Cir. 1985) (stating that an unsecured creditor who did not enter an appearance in a case for which it did not receive notice of a sale could not overturn the sale on appeal because Bankruptcy Rule 2002(i) specifically contemplates the limiting of notice to committees and parties-in-interest who have entered appearances in the case).
\item \textsuperscript{41} See, e.g., Factors' & Traders' Ins. Co. v. Murphy, 111 U.S. 738, 742 (1884); Ray v. Norseworthy, 90 U.S. 128, 136 (1874); In re Ex-Cel Concrete Co., 178 B.R. 198, 205 (B.A.P. 9th Cir. 1995) (vacating an order approving a sale where a senior mortgagee did not receive notice of the sale and where the bankruptcy court had mistakenly been advised that the proceeds from the sale exceeded the amount of the mortgagee's lien); In re Fernwood Markets, 73 B.R. 616, 620 (Bankr. E.D. Pa. 1987) (concluding that section 363(m) does not protect a good-faith purchaser from claims of a lienholder who does not receive notice of the sale of its collateral); In re Wauka, Inc., 39 B.R. 734, 738 (Bankr. N.D. Ga. 1984) (holding that a purchaser who participated at an auction of the debtor's assets without knowledge of another party's right of first refusal would be permitted to submit another bid and the party holding the right of first refusal who did not receive actual notice of the sale would have an opportunity to match the alternative bid). Arguably, the failure to provide notice to a lienholder of property to be sold where liens will attach to the proceeds of the sale should not be fatal to the approval of the sale. See, e.g., In re Oyster Bay Cove, Ltd., 196 B.R. 251 (E.D.N.Y. 1996).
\end{itemize}
provided, at a minimum, to any official committees and the U.S. Trustee. The notice of the sale should include the "time and place of any public sale, the terms and conditions of any private sale and the time fixed for filing objections," as well as a general description of the property. The notice may also contain more information than typically included in notices of more routine matters.

Additionally, to avoid claims by unknown creditors for successor liability, prospective purchasers often insist that the debtor provide notice by publication of significant sales of assets in addition to providing notice

---

63 Id. at 2002(c)(1); see also id. at 6004(a) (stating the notice necessary for proposed use, sale, or lease of property).
64 Even if the debtor has obtained a court order specifying the style of captions of pleadings in the case, it may be prudent to modify the caption typically used for other pleadings in the case to include the debtor's "tax identification number" and "all other names used by the debtor within six years before filing the petition," particularly when the notice of sale is being sent to all creditors and equity security holders. See, e.g., id. at 1005, 2002(n).
65 An unknown creditor is one whose claim is not "reasonably ascertainable," or whose claim is "merely conceivable, conjectural, or speculative." Charter Crude Oil Co. v. Petroleos Mexicanos, 125 B.R. 650, 655 (M.D. Fla. 1991) (citing Tulsa Prof'l Collection Servs., Inc. v. Pope, 485 U.S. 478 (1988); In re GAC Corp., 681 F.2d 1295, 1300 (11th Cir. 1982)) (footnote omitted). See also Trump Taj Mahal Assocs v. O'Hara, No. 93-2056, 1993 WL 534494 (D.N.J. Dec. 13, 1993) (finding that a customer injured in a casino who had filed an incident report at the time of injury but refrained from further communication with the debtor until two years later was considered an unknown creditor). Chemetron Corp. v. Jones, 170 B.R. 83, 90 (W.D. Pa. 1994), rev'd, Chemetron Corp. v. Jones, 72 F.3d 341, 345-46 (3d Cir. 1995), cert. denied, 517 U.S. 1137 (1996) (refusing to find excusable neglect for unknown claimants who did not inform the debtor of claims in timely fashion even where they claimed they were unaware of claims prior to bar date); In re Waterman S.S. Corp., 59 B.R. 724, 727-28 (Bankr. S.D.N.Y. 1986) (holding that failure to receive bar date notice was the creditor's fault because he delayed seven months before informing the debtor of the claim).
66 FED. R. BANKR. P. 2002(I) (notice by publication); id. at 9008 (stating that the court shall determine the "form and manner" of such notice "including the newspaper or other medium to be used and the number of publications."); id. at 2002(a)(2) (authorizing notice other than by mailing). Publication notice of a debtor's bankruptcy filing and bar date constitutes sufficient notice to "unknown" creditors to satisfy due process. Charter Crude Oil, 125 B.R. at 655, 658 ("[P]ublication notice is legally adequate notice to unknown creditors, whether they be sophisticated trade creditors or individual tort claimants."). See In re Thomas McKinnon Sec., Inc., 159 B.R. 146, 148 (Bankr. S.D.N.Y. 1993) (citing Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950)). Notice of a contemplated sale by publication is generally sufficient notice to unknown creditors regardless of whether such creditors actually read the notice. See In re Best Prods. Co., 140 B.R. 353, 357-58 (Bankr. S.D.N.Y. 1992) ("The proper inquiry in evaluating [adequacy of] notice is whether the party giving the notice acted reasonably in selecting means likely to inform persons affected, not whether each person actually received notice.") (citing Weigner v. New York, 852 F.2d 646, 649 (2d Cir. 1988), cert. denied, 488 U.S. 1005 (1989)); Mullane, 339 U.S. at 315.
to "known" creditors by mail.\textsuperscript{67} Notice by publication is generally insufficient when actual notice is not provided to known creditors\textsuperscript{68} or creditors who could be identified with reasonable due diligence.\textsuperscript{69} The risk of a purchaser being unable to avoid successor liability claims greatly increases when the claim does not arise until after closing regarding the sale. It is particularly important when dealing with the sale of assets by a debtor, which is periodically the subject of product liability claims, for prospective purchasers to ensure that broad notices notifying creditors of the disclaimer of successor liability\textsuperscript{70} are sent to manufacturers, suppliers, distributors and customers to cut off such claims.\textsuperscript{71} There is, however, no "meaningful" manner to provide notice to "individuals who do not yet know they suffer from injury."\textsuperscript{72}

V. CONCLUSION

Chapter 11 may be a valuable option for dot-com companies contemplating liquidation under the Bankruptcy Code. There are several benefits to using Chapter 11 as opposed to Chapter 7 in liquidation, including, but not limited to, greater tax and securities regulation

\textsuperscript{67}A creditor is presumed to have received notice when such notice is timely and properly mailed by the debtor.\textit{In re Texaco}, Inc., 182 B.R. 937, 954 (Bankr. S.D.N.Y. 1995); Trump Taj Mahal Assocs. v. Alibrahim, 156 B.R. 928, 939 (Bankr. D.N.J. 1993)\textit{aff'd}, No. 93-2056, 1993 WL 534494 (D.N.J. Dec. 13, 1993); \textit{In re Torwico Elec.}, 131 B.R. 561, 573 (Bankr. D.N.J. 1991); see also Hagner v. United States, 285 U.S. 427, 430 (1932) (stating the general rule that a letter properly sent "creates a presumption that it reached its destination in usual time and was actually received by the person to whom it was addressed").


\textsuperscript{69}Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 798 n.4 (1983) (stating that a creditor's identity is reasonably ascertainable or "reasonably identifiable," if the creditor can be identified through "reasonably diligent efforts"); Chemetron, 72 F.3d at 345 ("If claimants were 'known' creditors, then due process entitled them to actual notice of the bankruptcy proceedings. . . If, claimants were 'unknown' creditors, however, then notice by publication was sufficient to satisfy the requirements of due process."). A debtor, however, is not necessarily required to "search out each conceivable or possible creditor." \textit{Charter Crude Oil}, 125 B.R. at 655.

\textsuperscript{70}Western Auto Supply Co. v. Savage Arms, Inc. (\textit{In re Savage Arms}, Inc.), 43 F.3d 714, 723 (1st Cir. 1994) (rendering purchaser exposed on claims of successor liability for failure to provide notice of such claims to distributors of guns made by debtor).

\textsuperscript{71}Zerand-Bernal Group, Inc. v. Cox, 23 F.3d 159, 161 (7th Cir. 1994); Fairchild Aircraft Inc. v. Cambell (\textit{In re Fairchild Aircraft Corp.}), 184 B.R. 910 (Bankr. W.D. Tex. 1995).

\textsuperscript{72}Kewanee Boiler Corp. v. Smith (\textit{In re Kewanee Boiler Corp.}), 198 B.R. 519, 530 (Bankr. N.D. Ill. 1996).
protections and management retaining control of the entity, as opposed to a trustee who is not familiar with the debtor's operations. Nevertheless, the debtor needs to be aware of what the court deems as the ordinary course of business in carrying out an asset sale, as well as the notice and procedure requirements in effectuating the sale of substantially all of the debtor's assets to stay in compliance with the Bankruptcy Code and not throw away any of the benefits gained.