

Why 363 Sales Are So Popular: Win For All

By Dan Rexford

At the last Mid-Atlantic American Bankruptcy Institute (ABI) conference, the question: “Why are there so many sales?” was asked repeatedly by panelists, audience members, and judges. Professionals who commit their professional energies to maximizing the value of distressed businesses know the answer well but revisiting the subject is worthwhile here, if for no other reason than to provide useful material so all parties understand the advantages.

The primary reason Section 363 sales are popular is because there are distinct business advantages for all constituencies – investors, debtors, debtors-in-possession, creditors, trade vendors, and professionals. The advantages to investors (buyers) are clear: The assets are conveyed free and clear of liens and encumbrances, relieving fears of lingering liabilities and causes of action, etc. By investing in this way, they can, in rudimentary terms, keep the good stuff and get rid of the bad stuff. Furthermore, investors rest easy knowing, at the close of a competition, they paid no more than the fair market price for the assets, a certainty they do not have if they negotiate with a creditor rather than participate in a process.

Advantages to owners and management are not as well appreciated, but they are substantial, and savvy business people seize the opportunities afforded by 363 sales. Owners can compete for the assets and enjoy all the advantages of the process afforded to any other investor – keeping the good stuff, getting rid of the bad stuff. If they have resources of their own, or can attract partners, they are well positioned. If they do not have access to money (which is often the case with smaller companies because they have already poured everything into the business), the process itself gives them tremendous opportunity to persuade investors attracted by the sales and marketing process to put them on the team. Who better knows the potential of the assets, or perhaps more importantly, what not to do going forward? Additionally, secured creditors often look more kindly on owners who maximize value when it comes to discussing personal guarantees.

The advantage of supporting a 363 sale process to the Debtor In Possession (DIP) is crystal clear: fulfillment of its fiduciary responsibility to maximize the value of the assets and recovery to creditors. Employing true professionals to conduct a robust, exhaustive and effective sales and marketing campaign to attract new investors is a far better way of maximizing value than poorly capitalized plans of reorganization that are highly likely to join the rank of “Chapter 22s.”

Because investors enjoy so many advantages, they will bid aggressively if a strong sales and marketing campaign has been properly executed. Obviously, aggressive bidding benefits creditors because it maximizes recovery. In 363s creditors also have the backstop afforded by credit bidding, eliminating the risk of taking a hair cut that is simply too severe. Finally, a recapitalized company that has shed the bad stuff may well be a good credit in the future, creating an avenue to get money out profitably.

Trade creditors garner similar advantages. Recovery is maximized and a new, more credit-worthy, customer is created. While they would prefer to have had their bills paid in full as in a normal course of business, this is often making the best of a bad situation.

Finally, 363 sales solve a vexing question for professionals: How do you provide the level of service and expertise clients deserve and require when the source of funding is by definition on shaky ground? A financial transaction that maximizes value resolves the issue by creating a pool of cash to pay administrative claims.

Taken together, these advantages explain why sales are so prevalent. Simply put, the business reasons are so sound and compelling in many circumstances that the technique is rightly popular. All constituencies benefit and recapitalized companies are given a fresh start, effectively achieving one of the primary public policy objectives of Chapter 11.