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Dealing in Distressed Energy Assets

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INTRODUCTION

Pricing volatility and business cyclicality in the energy sector periodically create the need for restructuring and reorganization.[1] A distressed energy company with excessive leverage or insufficient cash flow may pursue out-of-court or in-court asset sales to dispose of unprofitable or non-strategic assets, increase liquidity, and create operational efficiencies. Potential purchasers face differing benefits and risks when dealing in distressed assets depending on the specific circumstances in each transaction. This article generally focuses on the process of dealing in distressed assets in the energy space, with special focus on upstream assets, and reviews certain of the benefits and risks often encountered. Part I of this article will discuss out-of-court acquisitions from distressed sellers, and Part II will discuss acquisitions of distressed energy assets in bankruptcy.

I. OUT OF COURT ACQUISITIONS FROM DISTRESSED SELLERS

Acquisitions of assets from distressed energy sellers frequently occur out-of-court. This part will discuss the benefits and risks of such out-of-court transactions as compared to having such transactions approved as part of a bankruptcy proceeding.

A. The Benefit of Speed and Execution

The prompt execution of out-of-court asset purchases, with execution risk negotiated by the parties, potentially benefits buyers more than in-court sales. The sale of assets outside of the ordinary course of business in bankruptcy cases requires notice and a hearing before the sale can be approved and frequently involves parties with competing interests. These logistical hurdles often require additional time and impose potentially higher costs when compared to out-of-court transactions, particularly if the sale process is heavily contested and litigated. At the same time, as will be discussed further, *infra*, sales under court supervision can also proceed in a timely, negotiated manner, as is often the case when parties in interest seek the common goal of maximizing value through a transparent and vetted marketing process. Notwithstanding the benefit of expeditious execution in asset sales outside of bankruptcy, risks attendant to out-of-court sales by distressed entities exist, including potential allegations of fraudulent transfer and successor liability risk.

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1. *See* William Wallander *et al.*, *Energy Restructuring and Reorganization*, 10 TEX. J. OIL, GAS & ENERGY L. 1 (2014) [hereinafter Wallander] for a broader discussion on energy industry restructuring.

B. The Fraudulent Transfer Risk

In general, a "fraudulent transfer" (or "fraudulent conveyance") is a transfer of property made to another party either (1) with the actual intent to defer, hinder, delay, or defraud creditors (actual fraud), or (2) for less than reasonably equivalent value when the transferor is insolvent or has inadequate capital (constructive fraud). Both federal and state law provide avoidance actions and recovery remedies for fraudulent transfers based on actual or constructive fraud.

Under federal law, Bankruptcy Code § 548 provides that a transaction may be avoided for actual or constructive fraud if the transfer occurred within two years before the date of filing for bankruptcy.[2] Additionally, Bankruptcy Code § 544 allows trustees to bring fraudulent transfer actions based on actual or constructive fraud under state statutes.[3] All fifty states have laws prohibiting fraudulent transfers. While most states currently model such laws on the Uniform Fraudulent Transfer Act (UFTA), some still model their laws on the older Uniform Fraudulent Conveyance Act (UFCA). Still other states have recently updated their fraudulent transfer laws based on the Uniform Law Commission's 2014 amendments to UFTA, which renamed the Act the 2014 Uniform Voidable Transactions Act (UVTA).[4] The 2014 amendments, among other changes, incorporated choice of law rules and changed the statutory language to rid UVTA of any implication that constructively fraudulent transfers require fraud as opposed to statutory voidability.[5] As of March 2016, eight states—California, Georgia, Idaho, Kentucky, Minnesota, New Mexico, North Carolina, and North Dakota—have enacted UVTA, and four other states—Indiana, Iowa, Massachusetts, and Rhode Island—have, so far this year, introduced legislation seeking to do so.[6] Bankruptcy courts frequently view both federal and state law fraudulent transfer cases as persuasive precedent when interpreting fraudulent transfer statutes.[7]

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2. 11 U.S.C. §§ 548(a)(1)(A), (B) (2012).
3. 11 U.S.C. § 544.
4. For purposes of this Article, the phrase "uniform fraudulent transfer laws" refers to UFTA, UFCA, and UVTA collectively.
5. *See* UNIFORM VOIDABLE TRANSACTIONS ACT (FORMERLY UNIFORM FRAUDULENT TRANSFER ACT) (*as Amended in 2014*), Nat'l Conference of Comm'r on Unif. State Laws, *available at* http://goo.gl/eEQzSo (last visited March 23, 2016, 10:29 p.m.).
6. For a map of states that have enacted UVTA and states that have introduced legislation to adopt it this year, *see* the website for the Uniform Law Commission, *Voidable Transactions Act Amendments (2014) – Formerly Fraudulent Transfer Act*, *available at* http://goo.gl/5k8wIw(last visited March 23, 2016, 10:32 p.m.).
7. *See, e.g.*, *In re* Grandote Country Club Co., 252 F.3d 1146, 1152 (10th Cir. 2001).

Notably, many state statutes contain fraudulent transfer look-back periods beyond the Bankruptcy Code's two-year limitations period.[8] Under the version of UFTA adopted by most states, including Texas and Delaware, the limitations period for fraudulent transfers extends up to four years.[9] Under New York's version of UFCA, however, the limitations period spans up to six years after the conveyance.[10]

1. *Actual Fraud: Federal and State Law*

First, a trustee may avoid transfers made or obligations incurred by a debtor by establishing actual fraud. Broadly stated, to prove actual fraud under either Bankruptcy Code § 548 or state law enactments of the uniform fraudulent transfer laws, the trustee or debtor in possession must show that the debtor made the transfer or incurred the obligation "with actual intent to hinder, delay, or defraud" creditors.[11]

Bankruptcy courts often look for "badges of fraud" in determining whether a party possessed the requisite intent to constitute actual fraud.[12] The badges of fraud often comprise the following:

1) the transfer or obligation was to an insider;

2) the debtor retained possession or control of the property transferred after the transfer;

3) the transfer or obligation was concealed;

4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

5) the transfer was of substantially all of the debtor's assets;

6) the debtor absconded;

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8. 11 U.S.C. §§ 548(a)(1), (b) (2012) (permitting trustee to avoid any actual and constructive fraudulent transfers "made or incurred on or within 2 years before the date of the filing of the petition").

9. *See* TEX. BUS. & COM. CODE § 24.010 (1993) (setting forth the rule that, in order to commence a fraudulent transfer action beyond the four-year limit, the claim must be brought "within one year after the transfer or obligation was or could reasonably have been discovered by the claimant"); 6 DEL. CODE § 1309 (same).

10. N.Y. CODE § 213(8) ("[T]he time within which the action must be commenced shall be the greater of six years from the date the cause of action accrued or two years from the time the [claimant] discovered the fraud, or could with reasonable diligence have discovered it.").

11. 11 U.S.C. § 548(a)(1)(A).

12. *See, e.g.*, Williams v. Houston Plants & Garden World, Inc., 508 B.R. 11, 18–19 (Bankr. S.D. Tex. 2014) (citing *In re* Soza, 542 F.3d 1060, 1067 (5th Cir. 2008)).

7) the debtor removed or concealed assets;

8) the value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

10) the transfer occurred shortly before or shortly after a substantial debt was incurred; or

11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.[13]

Not all badges of fraud must be present for a bankruptcy court to find actual intent.[14] In fact, depending on the circumstances, a few badges may be sufficient to support a finding of actual fraud.[15]

2. Constructive Fraud: Federal and State Law

Next, if a trustee or debtor in possession is unable to establish actual fraud, it may nevertheless avoid transfers made or obligations incurred by a debtor under Bankruptcy Code § 548 by establishing constructive fraud (or voidability under UVTA). To prove constructive fraud under the Bankruptcy Code, the trustee or debtor in possession must show that the debtor received less than a "reasonably equivalent value" in exchange for such transfer or obligation, and that the debtor:

1) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

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13. TEX. BUS. & COM. CODE § 24.005(b); 6 DEL. CODE § 1304(b). *See also* CAL. CIV. CODE § 3439.04(b).

14. *See In re* ASARCO L.L.C. v. Ams. Mining Corp., 396 B.R. 278, 371–72 (S.D. Tex. 2008) ("It is not necessary that all or any one of these badges of fraud support a finding of fraudulent intent; nor can one badge alone make out an inference of actual intent to hinder, delay, or defraud creditors. Rather, 'the confluence of several [badges of fraud] in one transaction generally provides conclusive evidence of an actual intent to defraud.'") (internal citations omitted).

15. *Id.*

2) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

3) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

4) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.[16]

The state law enactments of the uniform fraudulent transfer laws apply a similar standard to that in Bankruptcy Code § 548(a)(1)(B). In Texas, for example, a trustee may establish constructive fraud as to a creditor, whether the creditor's claim arose *before or within a reasonable time after* the transfer was made or the obligation was incurred, by showing that the debtor made the transfer or incurred the obligation without receiving "reasonably equivalent value" for the transfer or obligation and:

1) "was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction"; *or*

2) "intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due."[17]

Additionally, most state law enactments of the uniform fraudulent transfer laws—including the Texas statute—provide that a transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before such transfer or obligation if the debtor made the transfer or incurred the obligation "without receiving a reasonably equivalent value in exchange for the transfer or obligation" *and* "was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation."[18] As a further consideration, a transfer made by a debtor is deemed fraudulent as to a creditor whose claim arose before such transfer occurred if the transfer was (1) "made to an insider for an antecedent debt," (2) "the debtor was insolvent at that time," *and* (3) "the insider had reasonable

16. 11 U.S.C. § 548(a)(1)(B) (2012).
17. TEX. BUS. & COM. CODE § 24.005(a)(2).
18. *See* TEX. BUS. & COM. CODE § 24.006(a); 6 DEL. CODE § 1305(a); CAL. CIV. CODE § 3439.05.

cause to believe that the debtor was insolvent."[19]As will be shown in greater detail *infra*, constructive fraud determinations often hinge on whether "reasonably equivalent value" was exchanged, and disputes frequently arise regarding the value of the assets transferred in the challenged transaction.

3. Defenses and Mitigating Risk of Avoidance

In an effort to mitigate exposure to fraudulent transfer claims, a purchaser should be aware of the potential risks attendant to entering into a transaction with a distressed seller. Additionally, a purchaser should consider whether relevant facts satisfy the elements of the legal tests for actual or constructive fraud and, if so, whether any affirmative defenses are available. Bankruptcy courts often consider the non-exclusive list of "badges of fraud" discussed *supra* as indicia of an intent to hinder, delay, or defraud creditors when a trustee is seeking to establish actual fraud under Bankruptcy Code § 548(a)(1)(A) or applicable state law.[20] A purchaser should be aware of the badges of fraud and their applicability to the transaction at issue.

Further, parties frequently litigate voidability issues and disputes regarding whether reasonably equivalent value was given for the assets transferred. Inherent in transactions with distressed entities, a purchaser always bears the risk that a bankruptcy court will look back in time and determine that less than reasonably equivalent value was given in exchange for distressed assets. The Bankruptcy Code does not define reasonably equivalent value; rather, a bankruptcy court makes that determination on a fact-intensive, case-by-case basis.

Determining whether reasonably equivalent value was given in exchange for estate property requires valuation of the assets exchanged.[21] Bankruptcy courts possess wide latitude in determining whether to value assets at fair market value as opposed to liquidation value.[22] Indeed,

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19. *See* TEX. BUS. & COM. CODE § 24.006(b); 6 DEL. CODE § 1305(b).
20. *See, e.g.*, *ASARCO L.L.C.,* 396 B.R. at 371–72.
21. *See* 11 U.S.C. § 101(32) (2012) (establishing that the determination of a debtor's insolvency be made according to "fair valuation"); 11 U.S.C. § 506(a) (2012) (declaring that the value of a secured creditor's claim shall be "determined in light of the purpose of the valuation"); *In re* Heritage Highgate, Inc., 679 F.3d 132, 141 (3d Cir. 2012) ("Congress envisioned a flexible approach to valuation [under 11 U.S.C. § 506(a)] whereby bankruptcy courts would choose the standard that best fits the circumstances of a particular case.") (citing H.R. Rep. No. 95–595, at 356 (1977) ("Courts will have to determine the value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case.").
22. *In re Heritage Highgate, Inc.*, 679 F.3d at 141.

valuing energy assets is a highly complex, yet inexact, science.[23] When faced with the difficult challenge of valuing energy assets, bankruptcy courts often use one of four valuation methods: (1) discounted cash flow, (2) comparable companies, (3) comparable transactions, or (4) market approach.[24]

Under the "discounted cash flow" (DCF) analysis, a company's future cash flow is projected and then discounted to present value utilizing the projected weighted average cost of capital.[25] Generally, a DCF analysis depends on three criteria: (1) the size of the expected future cash streams to be generated by the business; (2) the discount rate employed in determining the present value of such income streams; and (3) the terminal multiplier used to capture any residual value remaining in the business at the end of the projection period.[26] A company's past performance is commonly used to assess growth projections and estimates.[27] However, bankruptcy courts are not bound by specific metrics and are free to value assets based on the specific circumstances of each case. The further into the future a valuation extends, the more likely a bankruptcy court is to take a more conservative approach because time amplifies risk and unforeseeable contingencies.[28] Furthermore, courts are likely to shy away from more aggressive or selective valuations in contingent contexts.[29] As the energy industry continues to operate in new and remote locations, the process of calculating risks and estimating contingencies will continue to impact DCF analyses and create challenges in the valuation process.

By comparison, under the "comparable company" analysis, the relative value of peer companies is analyzed in order to determine the value of a debtor's assets. The comparable company valuation is comprised of two steps. First, the debtor's earnings before interest, taxes, depreciation, and amortization (EBITDA) is calculated. Then, in order to determine the debtor's value, "the multiple of a 'healthy' comparable company's market-assigned enterprise to its corresponding EBITDA" is

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23. *In re* Sherman, 157 B.R. 987, 989 (Bankr. E.D. Tex. 1993) ("No other area is more central to the bankruptcy process yet more perplexing to those practitioners and courts presented with its permutations than the question of valuation of assets.").

24. Hon. Christopher S. Sontchi, *Valuation Methodologies: A Judge's View*, 20 AM. BANKR. INST. L. REV. 1, 16 (2012) (quoting *In re* Chemtura Corp., 439 B.R. 561, 573 (Bankr. S.D.N.Y. 2010) ("It is important to remember that bankruptcy judges have become familiar and comfortable with the DCF, comparable companies and comparable transactions methodologies. Indeed, these methods are often referred to as the 'standard' methodologies.") [hereinafter Sontchi]; *See also* VFB L.L.C. v. Campbell Soup Co., 482 F.3d 624, 633 (3d Cir. 2007).

25. Sontchi, *supra* note 24, at 7.

26. *In re* Cellular Info. Sys., Inc., 171 B.R. 926, 930 (Bankr. S.D.N.Y. 1994).

27. *See In re* Mirant Corp., 334 B.R. 800, 836 (Bankr. N.D. Tex. 2005).

28. *Id.* at 827–29.

29. *Id.*

calculated and multiplied by the debtor's EBITDA.[30] The comparable company analysis can be challenging; identifying comparable companies can be difficult because risk exposure and industry contingencies frequently distinguish seemingly comparable companies based on differences in industry, energy operation, and geographic location.[31]

Alternatively, the "comparable transaction" analysis considers recent transactions of similarly situated assets and companies, which are then extrapolated and applied to scale the value according to a debtor's relevant assets or enterprise value.[32] Ideally, the comparable transaction should be as recent in time as possible and take place within similar market conditions,[33] and the details of the transaction should be straightforward and accessible.[34] These considerations are especially important in the oil and gas industry given the movement of commodity prices.

Finally, when utilizing the "market approach" analysis, courts look to market evidence and other economic indicators to assess the total capital value of a debtor and its assets.[35] The market value of a debtor may be estimated by looking to the stock or bond market price of a debtor's securities.[36] Despite its functionality, bankruptcy courts have expressed concerns regarding market value analysis, including: (1) the impact of "taint" or "stigma" of bankruptcy on an asset's price due to the market's

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30. Kerry O'Rourke, *Valuation Uncertainty in Chapter 11 Reorganizations*, 2005 COLUM. BUS. L. REV. 403, 420 (2005).

31. *See In re Mirant Corp*., 334 B.R. at 837–38.

32. *See* Sontchi, *supra* note 24, at 12–13.

33. *In re* Genco Shipping & Trading Ltd., 513 B.R. 233, 253 (Bankr. S.D.N.Y. 2014); *In re* Chemtura Corp., 439 B.R. at 585 ("I find that the [compared] transaction was indeed the most appropriate comparable transaction, both by nature of company being acquired and in time."); *In re* Exide Techs., 303 B.R. 48, 62–63 (Bankr. D. Del. 2003) (refusing to compare transactions in an industry where the market changed considerably from 1998 to 2002).

34. *See In re Chemtura Corp*., 439 B.R. at 585–86 (noting that the transaction does not need to be closed to be considered under this analysis if sufficient documentation is available).

35. *See* VFB L.L.C. v. Campbell Soup Co., 482 F.3d at 632–33; U.S. Bank Nat'l Ass'n. v. Verizon Commc'ns. Inc., 892 F. Supp. 2d 805, 808–14 (N.D. Tex. 2012).

36. *VFB L.L.C.*, 482 F.3d at 633 ("[A]bsent a compelling reason to distrust it, the market price is 'a more reliable measure of the stock's value than the subjective estimates of one or two expert witnesses.'") (citing *In re* Prince, 85 F.3d 314, 320 (7th Cir. 1996)).

tendency to irrationally undervalue distressed assets and companies;[37] (2) the uncertainties a bankruptcy case may create in valuing an already complex asset;[38] and (3) the existence of fraud or concealment of material information to the market.[39] Nonetheless, the trend among bankruptcy courts is to apply greater scrutiny when a party suggests a valuation that differs from the valuation derived via an active and discernible market.[40]

As part of the valuation process, parties often retain third party experts or consultants to evaluate energy transactions with distressed entities. Because valuation of energy assets is highly situational, bankruptcy courts must frequently make determinations based upon "battle[s] of the experts." Notably, bankruptcy courts have favored experts with real experience in the energy field, even if an expert lacks an advanced degree.[41]

Another defense strategy may be to argue solvency of the transferor at the time of the transfer. A "solvency opinion" or "valuation opinion" from a third party expert can support a buyer's valuation position and may help mitigate the risk that a party will bring an avoidance action to claw back the assets.[42] Further, in public company scenarios, securities trading values indicative of solvency can be utilized.[43] A third party "fairness opinion," which states that the transaction was done fairly both procedurally and substantively, may also support a buyer's valuation position.

Certain transfers can be defended from voidability if the transferee acted in "good faith" and the transfer was "for value" under applicable federal or state fraudulent transfer law. Bankruptcy Code § 548(c) provides that "a

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37. *In re Mirant Corp*., 334 B.R. at 834–35; *see also In re* Penn Cent. Transp. Co., 596 F.2d 1102, 1115 (3d Cir. 1979) (recognizing that, in some instances, "evidence of market value should be ignored because the market can be expected irrationally to undervalue the securities of a once-distressed company emerging from a lengthy reorganization"); *In re* New York, N.H. & H. R.R. Co., 4 B.R. 758, 792 (D. Conn. 1980) ("The stigma of bankruptcy alone is a factor that will seriously depress the market value of a company's securities."); *In re* Missouri Pac. R.R. Co., 39 F. Supp. 436, 446 (E.D. Mo. 1941) ("[The] debtors have been in the process of reorganization for eight years, which fact alone would necessarily result in a serious depression in the market value of its securities.").

38. *In re Mirant Corp.*, 334 B.R. at 834.

39. *See* Tronox Inc. v. Kerr McGee Corp. (*In re* Tronox Inc.), 503 B.R. 239, 298–303 (Bankr. S.D.N.Y. 2013) (indicating that market valuation was not indicative of value where the information was obscured).

40. *See, e.g*., *U.S. Bank Nat'l Ass'n.*, 892 F. Supp. 2d at 808–14; *VFB L.L.C.*, 482 F.3d at 632–33.

41. Floyd v. Hefner, 556 F. Supp. 2d 617, 639 (S.D. Tex. 2008) ("[The expert's] lack of a formal accounting degree does not disqualify his opinions in this case given the level of his professional experience in [the oil and gas] field.") (citing S. Cement Co. v. Sproul, 378 F.2d 48, 49 (5th Cir. 1967)).

42. *See In re Tronox Inc.*, 503 B.R. at 301–03.

43. Trustee of the Idearc Inc. Litigation Trust v. Verizon Commc'ns. Inc. (U.S. Bank Nat'l Assn. Litigation), 817 F. Supp. 2d 934 (N.D. Tex. 2011); Statutory Comm. of Unsecured Creditors v. Motorola, Inc. *(In re* Iridium Operating L.L.C.), 373 B.R. 283 (Bankr. S.D.N.Y. 2007).

transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred" to the extent the transferee or obligee exchanged value for such transfer or obligation.[44] Similarly, UFTA, as adopted by Texas and Delaware, provides that a transfer or obligation is not voidable against a person who took in good faith for reasonably equivalent value.[45] The valuation methods discussed *supra* also come into play with respect to the value prong of this defense. As to whose perspective will determine value in the context of this affirmative defense (i.e., the transferee's or the creditor's), the result may vary depending upon whether Bankruptcy Code § 548(c) or state law is applied.[46]

4. *Recovery of Assets Transferred or the Value Thereof*

Once a transaction has been avoided, both the Bankruptcy Code and state law grant a trustee the power to recover fraudulently transferred assets, or the value of those assets, for the benefit of the bankruptcy estate.[47] Specifically, Bankruptcy Code § 550 provides that a trustee may recover the transferred property or its value from "(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee."[48]

A good faith purchaser or transferee holds a lien on the property to secure the value of any "improvements" made to the property after the transfer.[49] Additionally, an action for recovery may not be brought after the earlier of (1) one year after the avoidance of the transfer under bankruptcy law, or (2) the time the bankruptcy case is closed or dismissed.[50]

Similar to the standard set forth in § 550, many state fraudulent transfer statutes provide a comparable recovery standard. For example, Texas law provides that, to the extent a transfer is voidable, a creditor may recover the

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44. 11 U.S.C. § 548(c) (2012).

45. TEX. BUS. & COM. CODE ANN § 24.009(a) (2015); 6 DEL. CODE ANN. tit. § 1308(a) (2015).

46. *Cf.* Janvey v. Golf Channel, Inc., 780 F.3d 641 (5th Cir. 2015) *with* Williams v. FDIC (*In re* Positive Health Mgmt.), 769 F.3d 899 (5th Cir. 2014), *and* Jimmy Swaggart Ministries v. Hayes (*In re* Hannover Corp.), 310 F.3d 796 (5th Cir. 2002).

47. 11 U.S.C. § 550(a); *See also* 11 U.S.C. § 550(d) ("The trustee is entitled to only a single satisfaction . . . .")

48. 11 U.S.C. § 550(a). However, Bankruptcy Code § 550(b) provides that for any immediate or mediate transferee of such initial transferee under Bankruptcy Code § 550(a)(2), the trustee may not recover from: "(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or (2) any immediate or mediate good faith transferee of such transferee." 11 U.S.C. § 550(b).

49. 11 U.S.C. § 550(e).

50. 11 U.S.C. § 550(f).

lesser of the value of the asset transferred or the amount of the creditor's claim against: "(1) the first transferee of the asset or the person for whose benefit the transfer was made; or (2) any subsequent transferee other than a good faith transferee who took for value or from any subsequent transferee."[51] Additionally, Texas law provides that if the creditor's recovery is based on the value of the asset transferred, the value is calculated as of the time such asset is transferred, subject to equitable adjustment as necessary.[52]

5. *Examples of Recent Fraudulent Actions*

Recent examples of fraudulent transfer actions help illustrate the application of fraudulent transfer laws.[53] For example, in its 2008 decision in *In re ASARCO*, the District Court for the Southern District of Texas considered whether a transaction, by which a parent company received a transfer of the "crown jewel" asset of its subsidiary, constituted an actual or constructive fraudulent transfer.[54] The plaintiffs, ASARCO (a copper mining company) and its wholly-owned subsidiary, sued the debtor's parent corporation, Americas Mining Corporation (AMC), claiming that AMC's transfer of Southern Peru Copper Company's (SPCC) stock constituted a fraudulent transfer.[55] ASARCO had directly held a majority ownership interest in SPCC, which was a very profitable company.[56] However, when AMC acquired ASARCO, AMC directed that the SPCC stock be transferred to a subsidiary wholly-owned by ASARCO, Southern Peru Holding Company (SPHC), which ASARCO alleged had been set up by AMC as a sham entity in order to hold the SPCC stock—allowing for pledging of the stock as loan collateral while also removing it from the reach of ASARCO's creditors.[57] Notably, the stock removal occurred after AMC bought ASARCO without completing full due diligence, thereafter discovering ASARCO's substantial environmental liabilities.[58] Subsequently, AMC caused SPHC to transfer its shares in SPCC to AMC.[59] The court pierced the veil between SPHC and ASARCO so that ASARCO could challenge the transfer of the SPCC stock to AMC as a fraudulent transfer of property of ASARCO.[60]

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51. TEX. BUS. & COM. CODE § 24.009(b).
52. TEX. BUS. & COM. CODE § 24.009(c)(1). Texas law also provides that courts are not to adjust the value of the assets transferred to include the value of improvements made by a good faith transferee. TEX. BUS. & COM. CODE § 24.009(c)(2).
53. In addition to the two prominent cases discussed in this section, see Appendix A for further examples of key fraudulent transfer cases.
54. *ASARCO L.L.C.*, 396 B.R. at 299–315.
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.*
60. *ASARCO L.L.C.*, 396 B.R. at 335.

The plaintiffs asserted actual and constructive fraudulent transfer claims pursuant to Bankruptcy Code § 548 and the Delaware fraudulent transfer statute.[61] Regarding constructive fraud, the court looked to Delaware law and analyzed whether "reasonably equivalent value" was transferred for the SPCC stock transfer.[62] The court analyzed each aspect of consideration for the stock transfer, applying a market valuation with consideration of stock price, a comparable company analysis, and a discounted cash flow analysis in order to value the stock.[63] After completing its valuation, the court found that, under the totality of the circumstances, ASARCO received eighty-five to ninety percent of the SPCC stock's value, which constituted "reasonably equivalent value."[64] Accordingly, the plaintiffs' constructive fraudulent transfer claim failed.[65]

However, as to actual fraud, the court considered whether the SPCC stock transfer was made with the "actual intent to hinder, delay or defraud any creditor of the debtor" under Delaware law and Bankruptcy Code § 548.[66] As a threshold matter, the court found that, while the debtor must be the party who transfers with the intent to hinder, delay, or defraud creditors, AMC possessed the requisite domination and control of ASARCO such that actual fraudulent intent could be imputed to it.[67] Next, the court examined the statutory "badges of fraud" and other salient factors based on "all surrounding facts and circumstances."[68] The court found actual fraud based on intent to hinder and delay, particularly because AMC did not properly market the stock to the highest bidder, removed the "crown jewel" asset from the estate, concealed and altered information, broke promises to ASARCO's independent directors, and closed the transaction over the objections of the independent directors with knowledge that the transaction would hinder and delay the debtor

61. *Id.* at 335–94.
62. *Id.*
63. *Id.* at 342–64.
64. *Id.* at 364.
65. *Id.*
66. *ASARCO L.L.C.*, 396 B.R. at 364–65.
67. *Id.* at 369–70.
68. *Id.* at 370–80.

paying other creditors.[69] The court ultimately entered a judgment against AMC valued at over $6 billion.[70]

In another example, *In re Tronox*, the Bankruptcy Court for the Southern District of New York considered whether the spin-off of a profitable portion of a parent company's business that left the parent with substantial liabilities constituted an actual or constructive fraudulent transfer under the Oklahoma fraudulent transfer statute.[71] In this case, Old Kerr-McGee (later renamed "Tronox") was an energy company with a wide range of energy and chemical operations.[72] After a spinoff in 2006, Tronox retained substantial legacy environmental and tort liabilities that accrued over the course of seventy years, while the valuable oil and gas exploration and production business was transferred into the newly-formed New Kerr-McGee.[73] A few months after the spinoff, Anadarko Petroleum purchased New Kerr-McGee's recently acquired exploration and production business for $18 billion;[74] Tronox subsequently filed for bankruptcy on January 12, 2009.[75]

Regarding actual fraud, the court applied the Oklahoma fraudulent transfer statute, which provides a four year statute of limitations for fraudulent transfer claims.[76] The court distinguished between "intent to defraud" and "intent to hinder or delay" and found legally sufficient grounds to impose fraudulent transfer liability where defendants acted with the mere purpose or "intent to hinder and delay" creditors.[77] The court concluded that separating the E&P business and assets from the legacy liabilities was a primary driver in the spinoff and that the parties understood the adverse impact on Tronox's creditors.[78] Further, the court found evidence of "badges of fraud," including: (1) transfers among insiders; (2) retention of control of transferred assets; (3) "ineffective and

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69. *Id.* at 386–94.

70. According to the law firm representing ASARCO as debtor in possession, the value of the judgment exceeded $6 billion. *See* News Release, Baker Botts, Federal District Judge Awards ASARCO Damages Estimated at More Than $6 Billion, *available http://www.bakerbotts.com/news/2009/04/federal-district-judge-awards-asarco-damages-est* (last visited May 11, 2015). Some estimates of the value of the judgment range as high as $10 billion. *See, e.g.*, ASARCO L.L.C. v. Baker Botts, L.L.P. (*In re* ASARCO, L.L.C.), 751 F.3d 291, 293 (5th Cir. 2014), *cert. granted on other grounds*, 135 S.Ct. 44 (Oct. 2, 2014) (No. 14-103).

71. *In re Tronox Inc.*, 503 B.R. at 248–52.

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.* at 262–63.

76. *Id.* at 277.

77. *Id.* at 277–79 ("The *ASARCO* Court could also have cited *Shapiro v. Wilgus*, where the Supreme Court made it clear that the debtor's scheme did not have to be undertaken for nefarious or malicious purposes but merely with the purpose of hindering or delaying creditors.") (internal citations omitted).

78. *In re Tronox Inc.*, 503 B.R. at 280.

insubstantial" disclosure of transfers in SEC filings; (4) threats of litigation regarding legacy liabilities prior to the transactions; and (5) the transfer for substantially all of Tronox's assets.[79]

In the end, the court found unpersuasive the defendants' argument that a "legitimate supervening cause" for the transfer aimed at "unlocking" the chemical business existed.[80] Further, the court rejected the defense that the defendants believed Tronox would remain solvent and be able to continue to pay debts as they became due.[81] Instead, the court stated, the "real question is whether the [d]efendants had a good faith belief that Tronox would be able to support the environmental and other legacy liabilities that had been imposed on it."[82] Thus, the court concluded that actual intent to delay or hinder creditors had been established such that the spinoff constituted an actual fraudulent transfer under Oklahoma law.[83]

Regarding constructive fraud, the court again applied the Oklahoma fraudulent transfer statute. The court, by considering all related transactions together as a single transaction, found that Tronox did not receive "reasonably equivalent value" in the transaction.[84] The court also analyzed market evidence, contingent liabilities, and asset valuation.[85] While the defendants presented market evidence—including a successful initial public offering and an offer from a private equity firm to purchase Tronox's chemical business—the court rejected the market-based arguments, finding that the plaintiff's expert demonstrated that the numbers were inflated and "the financial statements on which the market relied were false and misleading."[86] The court put particular emphasis on valuing the environmental and tort liabilities, and it generally found the plaintiffs' experts to be more credible and the liabilities to be substantial.[87] Finally, in analyzing Tronox's business enterprise value, the court applied three different valuation methods to determine business enterprise value—discounted cash flow analysis, comparable company analysis, and comparable transaction analysis.[88] Based on numerous factors, the court found that Tronox was insolvent and unreasonably capitalized, and that the defendants reasonably should have believed that Tronox would be

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79. *Id.* at 282–85.
80. *Id.* at 285–89.
81. *Id.* at 285.
82. *Id.*
83. *Id.* at 288–91.
84. The court found that Tronox transferred property worth $17 billion ($15.8 billion in exploration and production assets) for only $2.6 billion in return. *In re Tronox Inc.*, 503 B.R. at 291–95.
85. *Id.* at 297.
86. *Id.* at 298–99.
87. *Id.* at 309–15.
88. *Id.* at 316–20.

unable to pay its debts as they became due.[89] Thus, constructive fraud was also established under Oklahoma law, and the defendants were held liable for billions of dollars owed to the bankruptcy estate. On January 23, 2015, the parties finalized a settlement agreement, wherein the defendants agreed to pay $5.15 billion, plus interest, to resolve the fraudulent transfer claims.[90]

C. Successor Liability and Bankruptcy Filing Risks

When a purchaser buys distressed assets outside of bankruptcy, the purchaser does not receive the assets "free and clear" of existing liens, claims, and encumbrances in the same manner as it would in a sale approved in a bankruptcy court proceeding. Instead, lien releases must be obtained, which may require significant diligence and expense and could create substantial delay. Without lien releases, a purchaser could face third party claims that would interfere with the purchaser's uninhibited use and right to the acquired assets.

Further, when engaging in out-of-court transactions, a party is faced with contractual restrictions, including anti-assignment provisions, consent rights, and rights of first refusal that may belong to third parties and may adversely impact an out-of-court transaction. Many contracts contain specific clauses granting third parties rights of consent or refusal that limit free assignability of certain assets or interests. While in the bankruptcy process a party need not always comply with contractual provisions restricting assignment, parties transacting outside of bankruptcy typically must comply with these provisions before transferring assets or interests to a third party. Such restrictive provisions can be problematic for a purchaser and can often disrupt the out-of-court sale process.

If a seller files for bankruptcy after signing a purchase agreement but before closing the transaction, a purchaser may find its transaction at risk due to a debtor's rights under Bankruptcy Code § 365 to reject the sale agreement as an executory contract. Also, if there are multiple related acquisition agreements, a debtor may seek to "cherry pick" acquisition agreements that it finds beneficial to assume and reject those it finds burdensome. Such cherry-picking could have the effect of materially and negatively affecting the overall economics of the transaction. If an agreement is rejected, the debtor will have no further performance

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89. *Id.* at 315–24.

90. Press Release, The U.S. Dep't of Justice, Historic $5.15 Billion Environmental and Tort Settlement with Anadarko Petroleum Corp. Goes into Effect (Jan. 23, 2015), *available at* http://www.justice.gov/opa/pr/historic-515-billion-environmental-and-tort-settlement-anadarko-petroleum-corp-goes-effect-0 (last visited May 15, 2015, 10:30 a.m.).

obligations, and the purchaser is entitled to assert a damages claim. In the event the transaction closes prior to a bankruptcy filing, a purchaser may also be left without enforceable warranties, representations, and indemnities under the terms of the agreement. Additionally, purchasers may find that certain payments made before closing, such as true-up payments or purchase price adjustments, may be challenged as avoidable preferences that may be recoverable by the bankruptcy estate. Tactics to mitigate risks in out-of-court transactions include negotiating contractual terms that take into account risks such as: (1) providing for a portion of the purchase price to be placed in escrow or otherwise reserved pending resolution of certain risks and contingencies; (2) obtaining liens on the distressed seller's assets to secure a party's obligations; or (3) integrating transaction contracts expressly and substantively to guard against a debtor's ability to "cherry pick," or reject some agreements while assuming others.

II. ACQUISITIONS OF DISTRESSED ENERGY ASSETS IN BANKRUPTCY

Given the potential risks for out-of-court transactions, a buyer considering a purchase of distressed assets out-of-court, alternatively, may consider a bankruptcy court-approved sale process. This part examines key facets of the options available in bankruptcy proceedings.

A. The 363 Sale Free and Clear of Claims and Interests

Purchasing energy assets in a bankruptcy process under Bankruptcy Code § 363 offers certain advantages over other types of out-of-court transactions. A § 363 asset sale affords the purchaser statutory protections and rights not found in an out-of-court transaction, typically involves less time, and does not require adherence to the procedural formalities otherwise required for a sale under a plan of reorganization. Perhaps most importantly, sales under Bankruptcy Code § 363 allow purchasers to take the assets "free and clear" of most claims, liens, and other interests.

Bankruptcy court approval is required for asset sales under Bankruptcy Code § 363 (as opposed to out-of-court transactions), and the bankruptcy court has broad discretion in deciding whether to authorize a Bankruptcy Code § 363 asset sale. Regular business transactions that occur on a day-to-day basis, however, are considered part of a debtor's "ordinary course of business" and do not require bankruptcy court approval. For example, a natural gas exploration and production company may continue to sell the gas it has produced in the ordinary course of business without notifying creditors or obtaining court approval.[91] By comparison, a sale of all or substantially all of a debtor's assets would constitute an "outside-the-ordinary-course" transaction requiring notice to parties in interest and bankruptcy court approval.[92]

In order to determine whether a particular use or sale of property falls within a debtor's ordinary course of business, bankruptcy courts generally apply a horizontal dimension test and a vertical dimension test.[93] Under the horizontal dimension test, bankruptcy courts look to whether the transaction at issue is one that would normally be entered into by similar businesses.[94] Under the vertical dimension test, courts look to whether the proposed transaction exposes the debtor's creditors to a different economic risk than that which would have been expected in the past (i.e., whether the proposed transaction is consistent with the debtor's past behavior).[95]

Historically, courts were reluctant to authorize asset sales in Chapter 11 bankruptcy cases absent sufficiently compelling circumstances, under the rationale that Chapter 11 is designed to reorganize a debtor's affairs, not liquidate its assets. Today, however, asset sales under Bankruptcy Code § 363 are fairly common in Chapter 11 cases. Bankruptcy courts can permit outside-the-ordinary-course asset sales under § 363 if the debtor demonstrates a sound business justification for the sale.[96] Even courts that are more hesitant to authorize § 363 sales will permit them in certain situations, including those where: (1) a company's going concern value[97] is declining and financing is contingent on a speedy sale; (2) a company

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91. Importantly, any party with an interest in the property to be used or sold may petition the bankruptcy court to prohibit or condition the debtor's use or sale of the property to the extent necessary to provide adequate protection of that party's interest. 11 U.S.C. § 363(e) (2012).

92. 11 U.S.C. § 363(b)(1).

93. *See In re* Roth Am., Inc., 975 F.2d 949, 952 (3rd Cir. 1992) (citing Benjamin Weintraub & Alan N. Resnick, *The Meaning of "Ordinary Course of Business" Under the Bankruptcy Code—Vertical and Horizontal Analysis,* 19 UCC L. J. 364 (1987)); Burlington Northern R.R. Co. v. Dant and Russel, Inc. (*In re* Dant and Russel, Inc.), 853 F.2d 700, 704 (9th Cir. 1988); Braunstein v. McCabe, 571 F.3d 108, 124 (1st Cir. 2009); Denton County Elec. Coop. v. Eldorado Ranch, Ltd. (*In re* Denton Cnty. Elec. Coop.), 281 B.R. 876, 882 n.12 (Bankr. N.D. Tex. 2002); Sunshine Heifers, L.L.C. v. Moohaven Dairy, L.L.C., 13 F. Supp. 3d 770, 775 (E.D. Mich. 2014).

94. *In re Roth Am., Inc.*, 975 F.2d at 953.

95. *Id*.

96. *See, e.g.*, *In re* Georgetown Steel Co., L.L.C., 306 B.R. 549, 555 (Bankr. D.S.C. 2004) ("Courts often review a debtor's use, sale or lease of property of the estate outside of the ordinary course of business pursuant to the debtor's demonstration of a sound business purpose.") (citations omitted); *In re* Enron Corp., No. 01-16034, 2003 WL 1562202, at *19 (Bankr. S.D.N.Y. Mar. 21, 2003) (citing *In re* Chateaugay Corp., 973 F.2d 141 (2d Cir. 1992)).

97. A "going concern value" is the value of a company as an ongoing entity, as contrasted to the value of the company's assets were the company to be liquidated.

would otherwise lose valuable customers absent an expedited sale; (3) a company's business depends on trade credit; or (4) a company's operating expenses exceed revenues.[98]

While the modern trend is to use the § 363 sale process as a potential end-goal of complex reorganizations,[99] some courts will not approve such a sale if it is determined to be a *sub rosa*, or secret, plan. A *sub rosa* plan is a disguised Chapter 11 plan of reorganization designed to evade compliance with proper plan procedures;[100] *sub rosa* plans are impermissible because they "short circuit" the Bankruptcy Code's requirements for plan confirmation.[101] As a result, bankruptcy courts scrutinize § 363 sales to ensure they do not improperly affect plan confirmation protections like creditor priorities. For example, the Fifth Circuit declined to authorize a proposed asset sale in *In re Braniff Airways*.[102] In that case, the assets proposed to be sold were plane landing slots that comprised a significant portion of the debtor's total assets.[103] Further, the sale agreement effectively established the terms of a Chapter 11 plan by, *inter alia*, requiring secured creditors to vote in favor of a subsequent plan of reorganization and releasing all claims against the debtor.[104] In practice, *sub rosa* objections are generally not successful unless the evidence points to a short-circuiting of the plan process by secretly establishing what should be terms of a plan in connection with the sale of assets.

1. *General Requirements for Sale Approval*

Under the first prong of the § 363 sale analysis, bankruptcy courts commonly conduct a four-factor inquiry examining: (1) whether the debtor has articulated a sound business purpose for the sale, (2) whether

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98. *See* Wachtell, Lipton, Rosen & Katz, *Distressed Mergers and Acquisitions*, at 50–52 (2013), *available at* http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.22377.13.pdf (last visited May 15, 2015, 10:32 a.m.) (hereinafter referred to as "Wachtell") (citing *In re* Chrysler L.L.C., 576 F.3d 108 (2d Cir. 2009), *aff'g In re* Chrysler L.L.C., 405 B.R. 84 (Bankr. S.D.N.Y. 2009); *In re* Gen. Motors Corp., 407 B.R. 463, 491-92 (Bankr. S.D.N.Y. 2009); *In re* Boston Generating, L.L.C., 440 B.R. 302, 329 (Bankr. S.D.N.Y. 2010)).

99. *See* Jacob A. Kling, *Rethinking 363 Sales*, 17 STAN. J. L. BUS. & FIN. 258, 262–94 (2012).

100. *In re* Gulf Coast Oil Corp., 404 B.R. 407, 416-18 (Bankr. S.D. Tex. 2009); Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983).

101. *In re Braniff Airways, Inc.*, 700 F.2d at 939–40.

102. *Id.* ("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 the sale of assets.").

103. *Id.*

104. *Id.*

the offer is fair and reasonable, (3) whether adequate and reasonable notice has been given, and (4) whether the parties acted in good faith.[105]

a. Respect of the Debtor's Business Judgment

Bankruptcy courts generally apply a "business judgment test" to determine whether a sound business-related purpose underlies a proposed outside-the-ordinary-course asset sale such that it should be authorized.[106] In assessing the soundness of a debtor's business decision to sell its assets outside of the ordinary course of business, bankruptcy courts commonly consider factors such as:

1) the proportionate value of the asset to the estate as a whole;

2) the amount of time elapsed 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 future plans of reorganization;

5) the proceeds to be obtained from the disposition regarding appraisals of the property;

6) which of the alternatives of use, sale, or lease the proposal envisions;

7) the estate's liquidity until confirmation of a plan;

8) alternative sales options at the time of confirmation; and

9) whether the assets to be sold are increasing or decreasing in value.[107]

b. The Need to Be Fair and Reasonable

While bankruptcy courts place great emphasis on the business judgment prong of the test, a debtor must also establish that the price and

105. *In re* Exaeris Inc., 380 B.R. 741, 744 (Bankr. D. Del. 2008) (citing *In re* Del. & Hudson Ry. Co., 124 B.R. 169, 176 (D. Del. 1991)); *see also* Sugarloaf Indus. & Mktg. Co. v. Quaker City Castings, Inc. (*In re* Quaker City Castings, Inc.), 2005 Bankr. LEXIS 2211, at *22-24 (B.A.P. 6th Cir. Nov. 18, 2005).

106. *See In re* Lionel Corp., 722 F.2d 1063, 1070 (2d Cir. 1983); Stephens Indus., Inc. v. McClung, 789 F.2d 386, 390 (6th Cir. 1986); *In re Quaker City Castings, Inc.*, 2005 Bankr. LEXIS 2211, at *22–24.

107. *See, e.g.*, *In re* Cont'l Air Lines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986) (citing *In re Lionel Corp.*, 722 F.2d at 1071).

terms of the sale agreement are "fair and reasonable."[108] Whether the terms of a proposed sale are fair and reasonable depends on the circumstances of each case.[109] A debtor properly marketing or "shopping" assets will increase the likelihood that a bankruptcy court will find a proposed sale price to be fair and reasonable. Further, while the Bankruptcy Code does not require sale by auction, debtors frequently sell their assets by auction because the auction process is considered an effective means of effectuating a fair arm's-length transaction.[110] Notably, if an insider or fiduciary of the debtor is purchasing assets from the debtor, bankruptcy courts apply a heightened standard of review, discussed *infra*, to ensure the sale price is fair and reasonable.[111]

c. *The Need for Adequate and Reasonable Notice of the Sale*

In addition to the requirements that a sale be fair, reasonable, and supported by a sound business justification, the debtor must further be sure to provide proper and adequate notice of its proposed asset sale. Bankruptcy courts will not authorize a sale under Bankruptcy Code § 363 unless the debtor provides sufficient notice to parties in interest, such that all parties have a meaningful opportunity to respond and object to the proposed sale, if warranted.[112] As a general rule of thumb, a debtor must give creditors and parties in interest at least twenty-one days' notice of the proposed sale, unless the court shortens the required notice period.[113]

d. *The Need for Good Faith of the Debtor and Prospective Buyer*

Lastly, the asset sale must be proposed in "good faith." When assessing the good faith of a proposed sale, bankruptcy courts commonly

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108. *See, e.g.*, *In re* Reese, No. 06–50133–RLJ–11, 2006 WL 6544094, at *4–5 (Bankr. N.D. Tex. July 11, 2006).

109. *Id.*

110. Rule 6004(f) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") provides that sales not in the ordinary course of business may be either by private sale or by public auction. FED. R. BANKR. P. 6004(f).

111. *In re* Mallory Co., 214 B.R. 834, 837–38 (Bankr. E.D. Va. 1997).

112. *See, e.g.*, *In re* Naron & Wagner, Chartered, 88 B.R. 85, 89 (Bankr. D. Md. 1988) (The debtor "must provide notice to all parties in interest . . . to [sufficiently] inform [them] of the anticipated impact of the sale on debtor's business and/or anticipated plan. For example, . . . the notice should contain enough information to alert interested parties that this is their last chance to be heard.").

113. *See* FED. R. BANKR. P. 2002(a)(2) (requiring at least twenty-one days' notice of a proposed sale of property of the estate "other than in the ordinary course of business, unless the court for cause shown shortens the time or directs another method of giving notice"). Some local rules vary the required notice period.

scrutinize the conduct of both the debtor and the prospective buyer.[114] While there is no bright-line test for "good faith," bankruptcy courts generally look for signs of fraud, collusion, and unfair bidding procedures in connection with a proposed sale. If an "insider" or a fiduciary is involved, bankruptcy courts apply a heightened standard of scrutiny and focus on whether the insider or fiduciary received special treatment with respect to the proposed transaction.[115] Accordingly, if a Bankruptcy Code § 363 sale involves an insider or a fiduciary of the debtor, the parties to the transaction should disclose to the bankruptcy court the nature of the relationship between the parties, the circumstances surrounding the negotiation process, and the process by which the debtor ultimately determined the price and terms of the sale to be fair and reasonable.

2. Free and Clear Sales Requirements

As mentioned *supra*, unlike asset sales outside of bankruptcy, a primary benefit of conducting asset sales pursuant to Bankruptcy Code § 363 is that the assets are sold "free and clear" of existing liens and encumbrances.[116] While there are several limitations to a free and clear sale, and while the Bankruptcy Code's protections are not absolute, purchasers of a debtor's assets with bankruptcy court approval are afforded substantial protection from a debtor's liabilities.

Under Bankruptcy Code § 363(f), a trustee or debtor in possession may sell property free and clear of any interest of any entity other than the estate in such property, provided that at least one of five conditions is established:

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114. *See* Wachtell, *supra* note 98 at 58; *In re Boston Generating, L.L.C.*, 440 B.R. at 330.
115. *See In re Mallory Co.*, 214 B.R. at 837–38.
116. 11 U.S.C. § 363(f) (2012).

1) applicable non-bankruptcy law permits the sale of such property free and clear of such interest;[117]

2) such entity consents;

3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;[118]

4) such interest is in bona fide dispute;[119] or

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117. Relevant non-bankruptcy law will typically be applicable state law. *See In re Curry*, 347 B.R. 596, 600 (6th Cir. B.A.P. 2006) ("When disputes over whether property is included in the estate arise, the bankruptcy court will determine the status and nature of the debtor's ownership or interest in the disputed property under applicable non-bankruptcy law, often state law, as of the time the bankruptcy petition was filed.") (citing *Butner v. United States*, 440 U.S. 48, 54-55 (1979)). There is currently a split in authority as to whether state foreclosure law may constitute "applicable non-bankruptcy law" under § 363(f)(1). *Compare In re* Jaussi, 488 B.R. 456, 458–59 (Bankr. D. Colo. 2013) (limiting scope of "applicable non-bankruptcy law" under § 363(f)(1) to legal options available to the debtor rather than to outside parties); Dishi & Sons v. Bay Condos L.L.C., 510 B.R. 696, 709–10 (S.D.N.Y. 2014) (limiting scope of provision to voluntary property transfers rather than New York foreclosure law); *with In re* Dulgerian, No. 06-10203 (JKF), 2008 WL 220523, at *4 (Bankr. E.D. Pa. Jan. 25, 2008) (citing to Pennsylvania foreclosure law to legitimate the free and clear sale of property to satisfy a mortgage while extinguishing an easement granted subject to the mortgage); *In re* Spanish Peaks Holdings II, L.L.C., No. 12-60041, 2015 WL 3767099, at *1 (D. Mont. June 16. 2015) (Montana foreclosure law constitutes "applicable nonbankruptcy law" for purposes of § 363(f)(1)); *In re* Wrangell Seafoods, Inc., No. K09-00012-DMD, 2009 WL 8478297, at *1 (Bankr. D. Alaska March 9, 2009) (Alaska foreclosure law constitutes "applicable nonbankruptcy law" for purposes of § 363(f)(1)); *In re* F.F. Station L.L.C., No. 6:07-BK-00575-ABB, 2007 WL 4898367, at *2 (Bankr. M.D. Fla. Dec. 3, 2007) (allowing sale of mortgaged property under § 363(f)(1) and (4) free and clear of leasehold interests).

118. Courts are split as to whether "value" as used here refers to the economic value or the face value of the liens. Most courts have concluded that the "aggregate value" refers to economic value. *In re Boston Generating, L.L.C.*, 440 B.R. at 332 ("As this Court held [previously], section 363(f)(3) should be interpreted to mean that 'the price must be equal to or greater than the aggregate *value* of the liens asserted against it, not their *amount*.'") (emphasis original, internal citations omitted); *In re* WK Lang Holdings, L.L.C., 2013 Bankr. LEXIS 5224, at *26-27 (Bankr. D. Kan. Dec. 11, 2013); *but see* Clear Channel Outdoor, Inc. v. Knupfer (*In re* PW, L.L.C.), 391 B.R. 25, 40-41 (9th Cir. B.A.P. 2008) ("[W]e join those courts . . . that hold that § 363(f)(3) does not authorize the sale free and clear of a lienholder's interest if the price of the estate property is equal to or less than the aggregate amount of all claims held by creditors who hold a lien or security interest in the property being sold.").

119. A "bona fide dispute" requires the interest to be in dispute on a fundamental level, and not simply contested on a peripheral or tangential matter. *See In re* Restaurant Assocs., L.L.C., No. 1:06CV53, 2007 WL 951849, at *9 (N.D. W. Va. Mar. 28, 2007).

5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[120]

The Bankruptcy Code does not define "interest" for purposes of Bankruptcy Code § 363(f). While some bankruptcy courts narrowly interpret "interest" to mean an *in rem* interest in property (e.g., a lien), most apply an expansive reading of the term and have found it to include liens, claims, and other encumbrances, except for "restrictions of record that run with the land."[121]

A sale free and clear under Bankruptcy Code § 363 requires that adequate protection be provided to parties with interests in the assets being sold.[122] Congress intended adequate protection to guard against loss in value of a secured creditor's interest in property of the bankruptcy estate during the bankruptcy case.[123] Adequate protection is based on the fundamental principle that secured creditors should not be deprived of the benefit of their bargain. The burden of proof as to adequate protection is on the debtor; however, the entity asserting an interest in the asset or assets to be sold has the burden of proof regarding its interest in such property.[124] In many free and clear sales, as a form of adequate protection, the interests will attach to the sale proceeds with the same validity, extent, and priority as such interests had when they encumbered the assets prior to the sale.[125]

Bankruptcy Code § 363 also requires notice of the sale to be sent to all creditors and parties who have liens or other interests in the assets being sold.[126] This notice requirement is expansive as it applies to the often numerous oil and gas counterparties, oil and gas lessors, secured and unsecured creditors, and regulatory authorities with interests in the assets.

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120. 11 U.S.C. § 363(f).

121. *In re* Trans World Airlines, Inc., 322 F.3d 283, 289 (3d Cir. 2003) (finding that the trend seems to be toward a more expansive reading of "interests in property" that "encompasses other obligations that may flow from ownership of the property"); Silverman v. Ankari (*In re* Oyster Bay Cove)*,* 196 B.R. 251, 256 (E.D.N.Y. 1996) (finding that "the order to sell 'free and clear' has no [e]ffect on the dedication of the road and storm drain, which are easements that run *with* the land") (emphasis in original).

122. 11 U.S.C. § 363(e) (2012).

123. H.R. Rep. No. 95-595, 338–340 (1977); *In re* DeSardi, 340 B.R. 790, 796–97 (Bankr. S.D. Tex. 2006); *In re* Bovino, 496 B.R. 492, 502 (Bankr. N.D. Ill. 2013) (citing United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 370–71 (1998)).

124. 11 U.S.C. § 363(p).

125. *See*, *e.g.*, *In re* Sears Methodist Ret. Sys., No. 14-32821-11, 2015 Bankr. LEXIS 709, at *9–11 (Bankr. N.D. Tex. Mar. 5, 2015); *In re* Amidee Capital Group, Inc., No. 10-20041, 2010 Bankr. LEXIS 5702, at *10 (Bankr. S.D. Tex. Oct. 19, 2010).

126. FED. R. BANKR. P. 2002(a)(2).

a. Treatment of Easements and Covenants

Bankruptcy Code § 541 defines property of the estate to include, *inter alia*, "all legal or equitable interests of the debtor in property as of the commencement of the case."[127] Easements and covenants conveyed to third parties that run with the land (i.e., that are properly recorded in the relevant real property records) are not considered property of the debtor's estate under § 541 because the debtor does not hold a legal or equitable interest therein. As a result, a sale "free and clear of liens and other interests" generally does not impact restrictions of record that run with the land.[128]

As bankruptcy courts have noted, Bankruptcy Code § 363(f) is "not intended to sever easements and other non-monetary property interests that are created by substantive state law."[129] Accordingly, absent an easement owner's consent or a bona fide dispute regarding the easement, the Bankruptcy Code usually does not allow parties to utilize § 363(f) to sell property "free and clear" of a properly recorded easement or covenant.[130] However, the Fifth Circuit recently appeared to leave open the possibility that a § 363 sale could be free and clear of covenants running with the land if the bankruptcy court determined that one of the elements of Bankruptcy Code § 363(f) is met.[131] The real property records

127. 11 U.S.C. § 541(a).
128. *In re Oyster Bay Cove, Ltd.*, 196 B.R. at 256.
129. *Id.* at 255.
130. *See id.* at 256.
131. Newco Energy v. Energytec, Inc. (*In re* Energytec, Inc.), 739 F.3d 215, 225–26 (5th Cir. 2013) (determining that a right to a "transportation fee" for use of a gas pipeline system constituted a covenant running with the land, and the bankruptcy court should give the initial answer as to "what constitutes a qualifying legal or equitable proceeding for purposes of Section 363(f)(5)" to determine whether the land may be sold free and clear of such interests pursuant to Bankruptcy Code § 363(f)(5)). These issues, raised in the context of motions to reject executory contracts, have recently become of keen interest and importance in pending upstream bankruptcy cases. On March 8, 2016, the Bankruptcy Court for the Southern District of New York in *In re* Sabine Oil and Gas Corp., *et al.*, Case No. 15-11835 [Docket No. 872], issued a ruling granting a motion by an upstream debtor to reject midstream gathering contracts, which the midstream counterparties argued contain covenants running with the land that could not be rejected under Bankruptcy Code § 365. Although the Court granted the rejection motion, in light of the Second Circuit's ruling in Orion Pictures Corp. v. Showtime Networks, Inc., 4 F.3d 1095 (2d Cir. 1993), which requires that a disputed legal issue between the parties be decided in an adversary proceeding and not in the context of a contested matter, it issued only a non-binding ruling that the dedications in the midstream contracts did not constitute covenants running with the land or equitable servitudes under Texas law because the requirements of privity and touching and concerning the land were not satisfied. The United States Bankruptcy Court for the District of Delaware in *In re*

in the county in which the land is located will typically disclose any recorded easements and covenants on the property that will continue to burden the target assets after a sale.

b. Successor Liability and Future Claims

In addition to the foregoing limitations, successor liability issues may arise in free and clear energy asset sales. In the bankruptcy context, purchasers are usually protected from liability to existing tort claimants, provided such claimants had notice of and an opportunity to participate in the bankruptcy case.[132] This policy encourages purchasers of energy assets to participate in bankruptcy sales, thereby maximizing value received by the estate. Moreover, this policy treats similarly situated creditors equally by prohibiting existing creditors from prosecuting claims against a debtor's successor.

However, unlike the treatment of existing tort claimants, bankruptcy courts continue to debate whether or not they have the jurisdiction or the power to protect purchasers of distressed assets from future claims (i.e., claims that arise post-petition as a result of the debtor's prepetition conduct).[133] In general, bankruptcy courts faced with the issue of successor liability typically look to whether the future claimants have "claims" within the meaning of the Bankruptcy Code, such that their claims would fall within the bankruptcy court's jurisdiction.[134]

Bankruptcy courts generally employ one of three tests to determine whether a future claimant has a prepetition claim against a debtor: (1) the conduct test; (2) the prepetition relationship test; and (3) the *Piper* test.

Quicksilver Resources, Inc. *et al.*, Case No. 15-10585, took a similar motion under advisement on March 4, 2016, though in that case, the rejection motion follows and relates to a court-approved sale of substantially all of the Debtors' assets free and clear of liens, claims, and encumbrances, which complicates the issue of how and if rejection impacts covenants running with the land in GPAs, which already were subjected to the free and clear sale of assets under Bankruptcy Code § 363. A decision in *Quicksilver* is expected this month.

132. *See* Am. Living Sys. v. Bonapfel *(In re* All Am. of Ashburn, Inc.), 56 B.R. 186, 190–91 (Bankr. N.D. Ga. 1986); *In re* White Motor Credit Corp., 75 B.R. 944, 950–51 (Bankr. N.D. Ohio 1987); *In re* Pan Am. Hosp. Corp., 364 B.R. 832, 838 (Bankr. S.D. Fla. 2007); *In* re Remember Enters., 425 B.R. 757, 764–65 (Bankr. M.D.N.C. 2010).

133. *See*, *e.g*., Mooney Aircraft Corp. v. Foster *(In re* Mooney Aircraft, Inc.*)*, 730 F.2d 367, 375 (5th Cir. 1984); Zerand-Bernal Group, Inc. v. Cox, 23 F.3d 159, 163-64 (7th Cir. 1994) (finding that the bankruptcy court did not have jurisdiction to enjoin future tort claimants); *In re* Dura Auto. Sys., No. 06-11202, 2007 Bankr. LEXIS 2764, at *265–68 (Bankr. D. Del. Aug. 15, 2007).

134. *See In re* White Motor Credit Corp., 75 B.R. at 950–51; Morgan Olson L.L.C. v. Frederico *(In re* Grumman Olson Indus.*)*, 467 B.R. 694, 704 (S.D.N.Y. 2012); *In re* Dura Auto. Sys., No. 06-11202, 2007 Bankr. LEXIS 2764, at *265–68; *In re* Desa Holdings Corp., 353 B.R. 419, 426–27 (Bankr. D. Del. 2006).

Under the conduct test, a claim arises when the debtor's conduct giving rise to the claim occurred.[135] Under the prepetition relationship test, the claimant's relationship with the debtor must have existed prior to the filing of the bankruptcy petition.[136] The *Piper* test is a hybrid test combining both the conduct test and the prepetition relationship test to determine whether a tort victim holds a claim.[137]

3. Other 363 Sale Considerations

In addition to the foregoing § 363 sale considerations, other issues particular to in-court sales are worthy of note, including appeals and statutory mootness, bidder collusion, partitioning of co-owned property, and issues of interest to intellectual property licensees. These topics are addressed in the subparts that follow *infra*.

a. Appeals and Statutory Mootness

Bankruptcy Code § 363(m) provides that an authorized sale that is subsequently reversed or modified on appeal remains valid if the purchase was made in good faith and the sale was not stayed pending appeal.[138] Accordingly, the purchaser is generally protected from reversal of a sale,

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135. *See* Grady v. A.H. Robins Co. (*In re* A.H. Robins Co.), 839 F.2d 198, 202–03 (4th Cir. 1988); Lemelle v. Universal Mfg. Corp., 18 F.3d 1268, 1275 (5th Cir. 1994); *In re* Huffy Corp., 424 B.R. 295, 304 (Bankr. S.D. Ohio 2010); Morgan Olson, L.L.C.. v. Frederico (*In re* Grumman Olson Indus.), 445 B.R. 243, 251 (Bankr. S.D.N.Y. 2011) ("Under the conduct test, a right to payment arises when the conduct giving rise to the alleged liability occurred. In other words, all of the acts constituting the tort other than the manifestation of injury had occurred prior to the petition date.") (internal citations and quotations omitted).

136. *See In re* Piper Aircraft Corp., 162 B.R. 619, 622–24 (Bankr. S.D. Fla. 1994); *In re* Grumman Olson Indus., 445 B.R. at 251 n.8 ("Under the pre-petition relationship test, only individuals with 'some type of prepetition relationship with the Debtor' hold claims.") (internal citations omitted); *Lemelle*, 18 F.3d at 1276; *Huffy*, 424 B.R. at 304.

137. Epstein v. Official Comm. of Unsecured Creditors (*In re* Piper Aircraft, Corp.), 58 F.3d 1573, 1577 (11th Cir. 1995) (adopting a two-part test—the "*Piper*" test—that combined the conduct and pre-petition relationship tests to determine whether a tort victim holds a "claim"); *see also In re* Grumman Olson Indus., 445 B.R. at 253.

138. 11 U.S.C. § 363(m) (2012). The purchaser's knowledge of the pendency of an appeal is irrelevant.

so long as the purchaser acted in good faith and the other party failed to obtain a stay.[139]

Since the Bankruptcy Code does not define "good faith" for the purposes of § 363(m), courts typically apply traditional equity principles to guide their findings as to good faith in sale orders.[140] Examples of

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139. *See*, *e.g*., Licensing by Paolo v. Sinatra (*In re* Gucci), 105 F.3d 837, 839–40 (2d Cir. 1997) ("Though [Bankruptcy Code § 363(m)] in terms states only that an appellate court may not 'affect the validity' of a sale of property to a good faith purchaser pursuant to an unstayed authorization, and can even be read to imply that an appeal from an unstayed order may proceed for purposes other than affecting validity of the sale, courts have regularly ruled that the appeal is moot."); SBA v. XACT Telesolutions, Inc. (*In re* XACT Telesolutions, Inc.), 2006 U.S. Dist. LEXIS 621, at *16–18 (D. Md. Jan. 10, 2006) ("Once a bankruptcy sale has been consummated, [Bankruptcy Code] § 363(m) deprives courts of jurisdiction to review the sale except on the limited issue of whether the sale was made to a good faith purchaser."); Cargill, Inc. v. Charter Int'l Oil Co. (*In re* The Charter Co.), 829 F.2d 1054, 1056 (11th Cir. 1987); *but see In re PW, L.L.C.*, 391 B.R. at 35–37 ("Clear Channel") (narrowly construing Bankruptcy Code § 363(m) to apply only to the overall sale and not to the specific terms thereof). The Bankruptcy Appellate Panel's holding in *Clear Channel* remains controversial because it interprets Bankruptcy Code § 363(m) to permit reversal of the free and clear terms of a sale. The *Clear Channel* holding ignored prior Ninth Circuit authority applying Bankruptcy Code § 363(m) to a free and clear sale under Bankruptcy Code § 363(f) in *In re Robert L. Helms Const. & Dev. Co., Inc.*, 110 F.3d 1470, 1475 (9th Cir. 1997), and the *Clear Channel* decision has been heavily criticized by courts in the Ninth Circuit and in other jurisdictions. *See, e.g.*, Official Comm. Of Unsecured Creditors v. Anderson Senior Living Prop., L.L.C. (*In re* Nashville Living, L.L.C.), 407 B.R. 222, 229–32 (B.A.P. 6th Cir. 2009) (stating that "*Clear Channel* cited no case law for its conclusion and the overwhelming weight of authority disagrees with its holding that the [Bankruptcy Code] § 363(m) stay does not apply to the 'free and clear' aspect of a sale under [Bankruptcy Code] § 363(f)"); United States v. Asset Based Res. Group, L.L.C., 612 F.3d 1017, 1019 n.2 (8th Cir. 2010) ("This court has consistently applied this [§ 363(m) mootness] principle in the bankruptcy context. [Appellant], relying on [*Clear Channel*], contends that [Bankruptcy Code §] 363(m) moots only appeals challenging transfers of title, not appeals challenging other aspects of court-approved sales. This distinction is not persuasive.") (internal citations omitted); Ace Fire Underwriters Ins. Co v. Plant Insulation Co. (*In re* Plant Insulation Co.), 2012 U.S. Dist. LEXIS 189155, at *17–19 (N.D. Cal. Oct. 9, 2012) (rejecting *Clear Channel* and "adopting the more persuasive, latter line of authority" to find that "[b]ecause the designation is 'integral' to the sale authorized under [Bankruptcy Code] § 363(b), the doctrine of statutory mootness under [Bankruptcy Code] § 363(m) applies to this appeal, barring a showing by appellants that the purchase was not consummated in good faith"); *In re* Thorpe Insulation Co., 2011 U.S. Dist. LEXIS 38879, at *3–4 (C.D. Cal. Apr. 11, 2011) ("*Clear Channel* does support Appellants' position, but it has been widely criticized by courts and commentators and is generally unpersuasive.").

140. *See In re* Tempo Tech. Corp., 202 B.R. 363, 367 (D. Del. 1996) ("Neither the Bankruptcy Code nor the Bankruptcy Rules define 'good faith.' In construing this phrase, courts have therefore borrowed from traditional equitable principles, holding that the concept of 'good faith' speaks to the integrity of a party's conduct in the course of the bankruptcy sale proceedings.") (internal citations omitted).

conduct lacking good faith include fraud, collusion, and attempts to gain grossly unfair advantages over other bidders in the sale process.[141]

b. Collusion by Bidders Prohibited

Bankruptcy Code § 363(n) permits a trustee to: (1) avoid a sale if the price was controlled by an agreement among potential bidders, or (2) recover from a collusive party to the extent the value of the property sold exceeds the actual sale price.[142] A trustee may also recover any costs, attorneys' fees, or expenses incurred in avoiding a collusive sale or recovering funds from a collusive party.[143] Importantly, Bankruptcy Code § 363(n) also authorizes a bankruptcy court to assess punitive damages against a collusive party in favor of the estate if such party willfully engaged in collusive behavior.[144]

For purposes of § 363(n), a collusive agreement may be oral and need not take the form of an explicit written contract, but the agreement must be made with the intent to control the sale price, rather than merely affecting the price as an unintended consequence.[145] The mere existence of a joint bid or cooperation among bidders does not itself evidence bad faith or amount to collusive bidding under Bankruptcy Code § 363(n).[146] Bidders may choose to work together or split up assets in a joint bid in order to complete a large transaction. Courts have focused, in determining the good faith of bidders, on whether acts were disclosed to the bankruptcy court.[147]

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141. *Id.*
142. 11 U.S.C. § 363(n).
143. *Id.*
144. *Id.*
145. *See* Lone Star Indus. v. Compania Naviera Perez Companc, S.A.C.F.I.M.F.A. (*In re* New York Trap Rock Corp.), 42 F.3d 747, 752 (2d Cir. 1994) ("The influence on the sale price must be an intended objective of the agreement, and not merely an unintended consequence, for the agreement among potential bidders to come within the prohibition of § 363(n)."); *See also* Sunnyside Land, L.L.C. v. Sims (*In re* Sunnyside Timber, L.L.C.), 413 B.R. 352, 363 (Bankr. W.D. La. 2009).
146. *See*, *e.g.*, *In re* Edwards, 228 B.R. 552, 563–66 (Bankr. E.D. Pa. 1998).
147. *See, e.g.*, Kabro Assocs. v. Colony Hill Assocs. (*In re* Colony Hill Assocs.), 111 F.3d 269, 277 (2d Cir. 1997) ("Many courts ruling on challenges to a purchaser's good faith status have focused on whether the acts about which the appellant complained were disclosed to the bankruptcy court."); *In re* Sasson Jeans, Inc., 90 B.R. 608, 610 (S.D.N.Y. 1988) (explaining that the court was "hard pressed" to determine bad faith when a challenged relationship between bidder and debtor "was fully disclosed to the Bankruptcy Court").

c. Partitioning (Co-Ownership)

Energy assets often have multiple owners with subdivided or co-owned interests. In certain circumstances, pursuant to Bankruptcy Code § 363(h), a debtor may sell co-owned assets, including the co-owner's interests, without the co-owner's consent if the debtor accounts to the co-owner for its share of the proceeds.[148] Bankruptcy Code §§ 363(h) and 363(i) codify the right of the debtor or trustee, proceeding from the debtor's position as one of the joint tenants or tenants in common, to cause the liquidation of co-owned property when partition is impracticable and when the co-owner will not exercise its right of first purchase.[149] Importantly, Bankruptcy Code § 363(i) gives the co-owner a statutory right of first refusal in such a sale,[150] and Bankruptcy Rule 7001 requires an adversary proceeding to sell a co-owner's interests in assets.[151] An exception to this general rule precludes a debtor from selling co-owned assets used in the production, transmission, or distribution for sale of electric energy, natural gas, or synthetic gas for heat, light, or power.[152]

d. Licensees of Intellectual Property

Bankruptcy Code § 365(n) provides special statutory protection for licensees of rights to intellectual property,[153] allowing them to retain their rights under intellectual property agreements as those rights existed immediately preceding the filing of the bankruptcy case.[154] Thus, licensees maintain "squatter's rights" regardless of a debtor's decision to reject the executory intellectual property agreement and sell its intellectual property free and clear of the licensee's interest.[155]

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148. 11 U.S.C. § 363(h) (2012).

149. *See* Official Comm. of Unsecured Creditors v. Anderson Senior Living Prop., L.L.C. (*In re* Nashville Senior Living, L.L.C.), 407 B.R. at 222, 227 (B.A.P. 6th Cir. 2009).

150. 11 U.S.C. § 363(i).

151. FED. R. BANKR. P. 7001(3).

152. 11 U.S.C. § 363(h)(4). There is limited case law interpreting this provision as a safeguard for co-owners to prevent the sale of property without their consent.

153. The Bankruptcy Code defines "intellectual property" to include, to the extent protected by applicable non-bankruptcy law: (i) trade secrets; (ii) inventions, processes, designs, or plants protected under Title 35; (iii) patent applications; (iv) plant varieties; (v) works of authorship under Title 17; and (vi) mask works protected under Chapter 9 of Title 17. 11 U.S.C. § 101(35)(A).

154. 11 U.S.C. § 365(n).

155. *See, e.g.*, TMC AeroSpace, Inc. v. Joseph (*In re* Ice Mgmt. Sys.), No. 14-1046, 2014 WL 6892739, at *2 (B.A.P. 9th Cir. Dec. 8, 2014) (holding that "a sale free and clear of [a licensee's] rights under § 363(f) was an impermissible impairment of its elected license rights under § 365(n)").

For example, in *In re Dynamic Tooling Systems, Inc.*, a Chapter 11 debtor sought to sell its assets, including intellectual property, free and clear of all liens, claims, and interests, pursuant to a creditor's proposed plan of reorganization.[156] A licensee of the debtor's intellectual property elected to continue to use the licensed intellectual property.[157] While the creditor proposing the plan assured that the "free and clear" language proposed in the sale order would not bar the licensee's right to use the intellectual property, the bankruptcy court was not satisfied.[158] The court applied the adequate protection requirement under Bankruptcy Code § 363(e)[159] as grounds for ordering that the sale be subject to the licensee's rights in the debtor's intellectual property.[160]

B. The 363 Sale Mechanics and Procedures

The complexities particular to the necessary mechanics and procedures applicable to § 363 sales include those related to the marketing process, stalking horse bids, break-up fees, bidding procedures, and the negotiation of asset purchase agreements, which include many highly negotiated provisions. The details of these § 363 sale aspects are discussed in this section.

1. The Marketing Process

As part of the initial marketing process, sellers often utilize independent financial advisors, such as investment banks or consulting firms, to assess the value of assets to be sold and to test the marketplace for potential buyers. The marketing process helps to determine a fair and reasonable sale price, and it attracts as many potential buyers as possible. Moreover, a transparent marketing process helps to ensure the integrity of the sale and maximize value for the debtor's estate.

As discussed *supra*, where a debtor has not effectively marketed the assets sought to be sold in a Bankruptcy Code § 363 sale, a bankruptcy court may consider such action to be evidence of a lack of good faith,[161]

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156. *In re* Dynamic Tooling Sys., Inc., 349 B.R. 847, 855 (Bankr. D. Kan. 2006).
157. *Id.*
158. *Id.*
159. The Bankruptcy Code provides that, upon a timely request from a party that has an interest in property proposed to be used, sold, or leased, the court "shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest." 11 U.S.C. § 363(e).
160. *In re* Dynamic Tooling Sys., 349 B.R. at 856. Issues regarding assumption and assignment of certain intellectual property rights are discussed *infra*.
161. *See*, *e.g.*, *In re* Bidermann Indus. U.S.A., Inc., 203 B.R. 547, 549–53 (Bankr. S.D.N.Y. 1997); *In re* Boston Generating, L.L.C., 440 B.R. at 323–30.

particularly when the buyer is an insider or has inside connections to the potential sale. In contrast, when a transparent and robust marketing process has occurred, a bankruptcy court is more likely to find that a sale was fair.[162]

2. Stalking Horse and Break-Up Fees

"Stalking horse" is a term used to describe the initial prospective purchaser of a debtor's assets. It may be that a stalking horse emerges and engages in negotiations with the debtor before the debtor files for bankruptcy, or a stalking horse may be found post-petition during the marketing process. To invoke the powers and protections of the Bankruptcy Code, particularly those set forth in Bankruptcy Code § 363, the stalking horse may insist that the asset sale transpire in the bankruptcy forum.

The stalking horse typically spends considerable time performing due diligence on distressed assets and negotiating with the debtor to obtain satisfactory purchase terms. A stalking horse enjoys the distinct advantage of having access to diligence information early in the process, which enables it to make an initial bid on the assets. Given the time and energy expended by the stalking horse in preliminary negotiations for the debtor's assets and the threat of another buyer overbidding it at auction, the stalking horse may require a break-up fee in the event that it is not chosen as the successful bidder at auction. By reimbursing the stalking horse for transaction costs incurred in performing due diligence and in negotiating the terms of the asset purchase agreement and the bidding procedures,[163] break-up fees tend to: (1) encourage the stalking horse to make a binding offer; (2) encourage competitive bidding by evidencing the stalking horse's view of the value of the assets; (3) set a floor early in the sale process indicating the "worst case" outcome of the sale process; and (4) create momentum toward consummating a sale.[164] Depending on the size of the transaction, a break-up fee can generally range from three to five percent of the gross sale price.

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162. *In re Boston Generating, L.L.C.*, 440 B.R. at 323–30.

163. *See In re* APP Plus, Inc., 223 B.R. 870, 874 (Bankr. E.D.N.Y. 1998); U.S. Trustee v. Bethlehem Steel Corp. *(In re Bethlehem Steel Corp.)*, No. 02 Civ. 2854 (MBM), 2003 U.S. Dist. LEXIS 12909, at *27–28 n.11 (S.D.N.Y. July 23, 2003); Canatxx Gas Storage Ltd. v. Silverhawk Capital Partners, L.L.C., No. H-06-1330, 2008 U.S. Dist. LEXIS 37803, at *17–19 (S.D. Tex. May 8, 2008).

164. *See In re APP Plus, Inc.*, 223 B.R. at 874.

The permissibility of break-up fees falls within the discretion of the bankruptcy court.[165] Some bankruptcy courts apply the business judgment rule in upholding break-up fees, requiring the debtor's inclusion of a break-up fee in an asset purchase agreement to be based upon an informed, good faith business decision.[166] However, if a buyer is an insider of the debtor, a bankruptcy court may apply higher scrutiny to a break-up fee.[167] Bankruptcy courts focus on ensuring that Bankruptcy Code § 363 sales are in the best interest of the estate.[168] Bankruptcy courts that disfavor break-up fees generally view them as an unnecessary expense for the estate that may chill bidding,[169] and some argue that increasing the availability of information and standardizing bidding procedures would be a better approach.[170]

Among the relevant factors that courts consider when determining whether to approve a break-up fee are whether:

1) the fee requested is aligned with the policy of maximizing the value of the debtor's estate;

2) the underlying negotiated agreement constitutes an arm's-length transaction;

3) any of the debtor's secured or unsecured creditors have objected to the break-up fee;

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165. *See, e.g.*, *In re* Reliant Energy Channelview LP, 594 F.3d 200, 210 (3d Cir. 2010) (holding that "[t]he Bankruptcy Court did not abuse its discretion when it concluded that an award of a break-up fee was not necessary to preserve the value of the estate").

166. *See, e.g.*, Cottle v. Storer Commc'n, Inc., 849 F.2d 570, 579 (11th Cir. 1988) (holding a $29 million termination fee to be protected by the business judgment rule where the fee was not shown to be unreasonable in relation to a $2.5 billion transaction); *In re* ASARCO L.L.C., 441 B.R. 813, 825–33 (S.D. Tex. 2010).

167. *See, e.g.*, *In re* Bidermann Indus. U.S.A., Inc., 203 B.R. 547, 551 (Bankr. S.D.N.Y. 1997) (explaining that "sales to [insiders] in chapter 11 cases are not *per se* prohibited, but [they] are necessarily subjected to heightened scrutiny because they are rife with the possibility of abuse") (citing *In re* Wingspread Corp., 92 B.R. 87 (Bankr. S.D.N.Y. 1988)) (internal quotations omitted).

168. *See, e.g.*, *In re* Am. W. Airlines, Inc., 166 B.R. 908, 912 (Bankr. D. Ariz. 1994).

169. *See, e.g.*, *In re* S.N.A. Nut Co., 186 B.R. 98, 101–06 (Bankr. N.D. Ill. 1995) (finding that a break-up fee was not in the best interests of the estate); *In re Am. W. Airlines, Inc.*, 166 B.R. at 910–14 (stating that the appropriate standard is not the business judgment rule, but whether the break-up fee is in the best interests of the debtor, creditors, and equity holders); *In re* Beth Isr. Hosp. Ass'n, No. 06-16186 (NLW), 2007 Bankr. LEXIS 2386, at *31–42 (Bankr. D.N.J. July 12, 2007).

170. *See In re S.N.A. Nut Co.*, 186 B.R. at 103–04.

4) the break-up fee comprises a fair and reasonable portion of the proposed purchase price;

5) the size of the break-up fee is so significant that it imposes a chilling effect on competing bidders;

6) available safeguards exist that are beneficial to the debtor's estate; and

7) the break-up fee imposes a substantial adverse impact on unsecured creditors.[171]

3. *Bidding Procedures and Key Sale Process Steps and Deadlines*

Both bankruptcy courts and debtors generally favor asset sales by auction over private sales because the auction process, although not without its costs, generally yields the greatest value for a debtor's assets, and it usually produces a fair arm's-length transaction. Before an auction takes place, a debtor typically files and seeks court approval of proposed bidding and auction procedures. If the bankruptcy court approves the bidding procedures, the parties typically will serve a transaction notice on parties in interest and establish a timeline for certain events leading up to the auction.

Bidding procedures are highly negotiated and are often crafted based on the circumstances of each case. Examples of common terms in bidding procedures include:

1) a deadline by which parties must notify the debtor of their interest in the debtor's assets;

2) a deadline by which a draft of the form of asset purchase agreement is distributed to potential qualified bidders;

3) a deadline for potential qualified bidders to submit

   a) an executed confidentiality agreement acceptable to the debtor, and

   b) financial statements acceptable to the debtor, demonstrating the potential qualified bidder's financial capability and legal authority to close the proposed transaction in a timely manner;

4) a deadline for qualified bidders to submit competing bids;

171. *See In re* Hupp Indus., Inc., 140 B.R. 191, 194 (Bankr. N.D. Ohio 1992); *see also In re* Nashville Senior Living, 2008 Bankr. LEXIS 3197, at *6–10.

5) a requirement that competing bids contain substantially similar terms and conditions as those set forth in the stalking horse's proposed asset purchase agreement;

6) a requirement that all bids be made in certain incremental amounts;

7) a requirement that qualified bidders pay a minimum deposit;

8) provisions regarding reasonable overbid amounts;[172]

9) a date for the auction to take place;

10) terms that define or limit credit bidding;

11) provisions allowing the debtor to determine, in its discretion, the highest and best offer; and

12) a date for the hearing on the asset sale post-auction.[173]

Credit bidding is a term used to describe a creditor's authority to bid on assets secured by such creditor's lien. Credit bidding is authorized under Bankruptcy Code § 363(k); absent an order for "cause" otherwise, that provision allows a secured creditor to bid at auction and, if successful, offset its claim against the asset purchase price.[174] A secured creditor may credit bid in an amount up to its entire claim against the debtor, not just the secured

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172. *See In re* Hupp Indus., Inc., 140 B.R. at 193 (rejecting a $300,000 overbid amount as "arbitrary and unreasonably high"); U.S. Trustee v. Bethlehem Steel Corp. (*In re* Bethlehem Steel Corp.), No. 02 Civ. 2853 (MBM), 2003 U.S. Dist. LEXIS 12909, at *27–28 n.11 (S.D.N.Y. July 23, 2003).

173. A bankruptcy court may refuse to authorize a sale under Bankruptcy Code § 363 after an auction for a number of reasons, including submission by a prospective purchaser of a higher bid for the debtor's assets after the auction is completed. *See, e.g.*, Corporate Assets, Inc. v. Paloian, 368 F.3d 761, 762–63 (7th Cir. 2004) (upholding bankruptcy court's decision to authorize a second auction when higher bid was submitted after the close of the first auction). In the event that a prospective buyer submits such a post-auction bid, the bankruptcy court may reopen the auction in accordance with the Bankruptcy Code's fundamental policy of maximizing the value of a debtor's estate for the benefit of the debtor's creditors. *Id.* at 772–73 ("[T]he prospect of additional renumeration for the estate and its creditors outweighed concerns about the finality and regularity of the sale proceeding."); *see also* Hytken v. Williams, No. H-06-2169, 2007 U.S. Dist. LEXIS 27671, at *17–18 (S.D. Tex. Mar. 30, 2007).

174. 11 U.S.C. § 363(k) (2012).

portion of its claim.[175] Accordingly, a secured creditor may credit bid and purchase the property encumbered by its lien by prevailing at auction, but it may need to pay any amount of the purchase price that exceeds the total value of its claim or is owed to senior lienholders.[176] However, parties may seek agreements to limit credit bidding in certain circumstances, either by setting incremental thresholds for credit bidding or by prohibiting a lienholder from credit bidding against the stalking horse.

4. *Asset Purchase Agreements*

An asset purchase agreement (APA)—sometimes alternatively called a purchase and sale agreement (PSA)—is a highly complex document, heavily negotiated by the parties thereto. This subsection delves into provisions often found in an APA, including provisions allowing for the assignment of executory contracts and unexpired leases as well as provisions regarding rights of first refusal, consent rights, and preferences.

a. *Typical Provisions*

An APA is a contract between two or more parties that governs the terms and conditions regarding a future sale of certain specified assets. Bidding procedures generally require a qualified bidder to submit an APA to evidence its bid. Depending on the terms of the bidding procedures, qualified bidders may be required to submit APAs on substantially similar terms as the stalking horse's APA.

Among other provisions, APAs contain defined contract terms to be used in the APA, purchase and sale pricing and business terms, conditions to closing, representations and warranties, covenants, and termination provisions. APAs in energy transactions may also contain additional negotiated provisions, including those relating to:

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175. *See In re* SunCruz Casinos, L.L.C., 298 B.R. 833, 839 (Bankr. S.D. Fla. 2003) ("[T]he plain language of [Bankruptcy Code § 363(k)] makes clear that the secured creditor may credit bid its *entire claim*, including any unsecured deficiency portion thereof") (emphasis original); *In re* Midway Invs., Ltd., 187 B.R. 382, 391 (Bankr. S.D. Fla. 1995); *but see In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 61 (Bankr. D. Del. 2014) (holding that "the holder of a lien the validity of which has not been determined . . . may not [credit] bid its lien") (citing *In re* Daufuskie Island Props., L.L.C., 441 B.R. 60 (Bankr. D.S.C. 2010)).

176. *See* COLLIER ON BANKRUPTCY ¶ 363.09[3] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).

1) purchase price adjustments;

2) pre-closing covenants, such as maintenance of oil and gas assets, authorizations for expenditures (AFEs), and well elections;

3) property access;

4) indemnity by the potential buyer for liabilities caused by the buyer in the course of performing its due diligence;

5) limited title representations, defect mechanics, and hold-backs;

6) environmental diligence terms, defect mechanics, and hold-backs;

7) preferential rights to purchase, rights of first refusal, and consent rights;

8) anti-survival clauses;

9) termination rights;

10) default remedies;

11) closing conditions;

12) post-closing covenants; and

13) dispute mechanics.[177]

Until a debtor receives the bankruptcy court's approval, it cannot be bound by an APA executed outside of the ordinary course of business, even if it is negotiated in connection with a Bankruptcy Code § 363 sale.[178] Once the debtor obtains a court order approving the sale, the sale may close. Unlike a debtor, absent an express provision in the APA to the contrary, a purchaser may be bound by the terms of an APA upon

177. *See* Wallander, *supra* note 1 at 49-50.
178. 11 U.S.C. § 363(b)(1) (2012); *In re* Asia Global Crossing, Ltd., 326 B.R. 240, 256 (Bankr. S.D.N.Y. 2005) (holding that a debtor is not bound by a sale contract until it receives court approval).

execution, even if bankruptcy court approval has not yet been obtained.[179] As a result, it is not uncommon for purchasers to require that the effectiveness of an APA be contingent upon a satisfactory order by the bankruptcy court authorizing the sale.

b. Assignment of Executory Contracts and Unexpired Leases

Purchasers of oil and gas assets frequently seek to include in APAs a provision that requires certain executory contracts and unexpired leases to be assumed and assigned to them as part of a sale. An "executory contract" is commonly defined as "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."[180] "Unexpired leases" are leases of personal or real property that have not been terminated prior to the petition date with the specific interests defined by applicable state law.[181] Before an executory contract or unexpired lease may be assigned, a debtor must first assume it. That assumption triggers the requirements in Bankruptcy Code § 365(b) that: (1) the debtor cures any defaults under the executory contract or unexpired lease to be assumed, and (2) the assignee provides adequate assurance of its future performance under such contract or lease.[182] APAs frequently allocate payment of cure costs to the debtor or the purchaser. Notably, the Bankruptcy Code permits the assignment of an executory contract and unexpired lease, notwithstanding contractual "anti-assignment" provisions that might otherwise limit assignment.[183]

Intellectual property licenses are unique executory contracts. Accordingly, assignment of intellectual property licenses presents obstacles for buyers looking to purchase intellectual property from a distressed energy company. While Bankruptcy Code § 365(f)(1) renders anti-assignment provisions generally unenforceable, Bankruptcy Code

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179. The purchaser's execution of an APA constitutes a binding offer that may be accepted by the debtor with court approval. *See* RESTATEMENT (SECOND) OF CONTRACTS § 24 (1981) ("An offer is the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it.").

180. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973); *see also* Phoenix Exp., Inc. v. Yaquinto (*In re* Murexco Petro, Inc.), 15 F.3d 60, 62–63 (5th Cir. 1994); *but see* Chattanooga Mem'l Park v. Still *(In re* Jolly*)*, 574 F.2d 349, 351 (6th Cir. 1978) ("The key . . . is to work backward, proceeding from an examination of the purposes rejection is expected to accomplish. If those objectives have already been accomplished, or if they can't be accomplished through rejection, then the contract is not executory . . . .").

181. *See* Brattleboro Hous. Auth. v. Stoltz (*In re* Stoltz), 197 F.3d 625, 629 (2d Cir. 1999).

182. 11 U.S.C. §§ 365(f)(2)(A), 365(b).

183. 11 U.S.C. § 365(f)(1).

§ 365(c)(1) provides that a debtor may not assume or assign any executory contract or unexpired lease, if "applicable law" excuses another party to such contract or lease "from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession."[184] Bankruptcy Code § 365(c)(1) has been held to prohibit the assignment of certain executory contracts involving intellectual property that contain anti-assignment provisions because such assignments are prohibited under federal copyright, trademark, and patent laws.[185]

Indeed, a majority of courts forbid the assignment of contracts containing anti-assignment language by a debtor where such assignment is prohibited by intellectual property law.[186] Courts have found *non-exclusive* licenses to intellectual property to be non-assignable without the consent of the licensor or another party to the license.[187] However, courts remain split as to whether an *exclusive* license to intellectual property is assignable under Bankruptcy Code § 365(c)(1) without consent of the licensor or another party to the contract.[188]

c. *Rights of First Refusal, Consent Rights, and Preferences*

Many energy contracts, including joint operating agreements (JOAs), commonly include rights of first refusal or other preferential rights that may be triggered by a proposed asset sale. The law lacks clarity as to

184. 11 U.S.C. § 365(c)(1).

185. *See, e.g.*, *In re* Golden Books Family Entm't, Inc., 269 B.R. 300, 310 (Bankr. D. Del. 2001).

186. *See* RCI Tech. Corp. v. Sunterra Corp. (*In re* Sunterra Corp.), 361 F.3d 257, 262 (4th Cir. 2004); Perlman v. Catapult Entm't (*In re* Catapult Entm't), 165 F.3d 747, 751–53 (9th Cir. 1999).

187. N.C.P. Mktg. Grp. v. Blanks (*In re* N.C.P. Mktg. Grp., Inc.), 337 B.R. 230, 236–37 (D. Nev. 2005) (finding that federal common law, and thus Bankruptcy Code § 365(c)(1), prohibits assignment of nonexclusive trademark licenses without consent of the licensor), *aff'd*, 279 F. App'x 561 (9th Cir. 2008); *In re* Patient Educ. Media, Inc., 210 B.R. 237, 240–43 (Bankr. S.D.N.Y. 1997) ("Accordingly, the nonexclusive license is personal to the transferee, and the licensee cannot assign it to a third party without the consent of the copyright owner."); Isbell v. DM Records, Inc., 2013 U.S. Dist. LEXIS 189526, at *15 (E.D. Tex. July 16, 2013) ("[A] non-exclusive license to exploit a musical composition is not necessarily transferred when the rights to a master recording are purchased from a bankruptcy trustee. A copyright license cannot be transferred by the licensee without authorization of the licensor.").

188. *Compare* Gardner v. Nike, Inc., 279 F.3d 774, 777–81 (9th Cir. 2002) (holding that federal law bars assignment of exclusive copyright licenses "without the consent of the original licensor."), *with In re* Golden Books Family Entm't, Inc., 269 B.R. at 314–19 (holding that federal law permits assignment of exclusive copyright licenses regardless of licensor or counterparty consent because, "under applicable copyright law, exclusive licenses convey an ownership interest to the licensee that allows that licensee to freely transfer its rights.").

whether a debtor is bound by preferential rights in an executory contract or unexpired lease.[189] It is also unclear whether rights of first refusal or preferential rights to purchase can be considered executory contracts in and of themselves, such that a debtor may reject those rights if doing so would benefit the estate.[190] In energy bankruptcies, a sale might be impacted by a third party's preferential rights that, outside of bankruptcy, would be enforceable to substitute a third party as a purchaser.[191]

Some courts have compared preferential rights to options to purchase.[192] Most courts consider options to be executory until such an option is exercised.[193] Moreover, if an option holder must tender further consideration or take additional steps beyond merely signing a document or providing notice, courts are more likely to view the option as executory.[194] Accordingly, the preferential rights may be unenforceable if the agreement containing the preferential right is rejected.

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189. 11 U.S.C. § 365(f)(1) (2012).

190. *See In re* Riodizio, Inc., 204 B.R. 417, 422–24 (Bankr. S.D.N.Y. 1997) ("The case law confirms that executoriness [of option contracts] lies in the eyes of the beholder."); Unsecured Creditors' Comm. v. Southmark Corp. (*In re* Robert L. Helms Constr. & Dev. Co.), 139 F.3d 702, 705–06 (9th Cir. 1998) ("A better approach . . . is to ask whether the option requires further performance from each party at the time the petition is filed" and found that, typically, the option would not be executory because the "optionee need not exercise the option – if he does nothing, the option lapses without breach.").

191. Such rights may be enforceable, assuming the rights are valid under state law and do not constitute an unenforceable absolute restriction on alienation. *See generally* Wildenstein & Co. v. Wallis, 595 N.E.2d 828, 828 (N.Y. App. 1992).

192. ConocoPhillips Co. v. Dahlberg, No. CIV.A. C-10-285, 2011 WL 710604, at *1 n.2 (S.D. Tex. Feb. 22, 2011) ("A 'preferential right, also known as a right of first refusal or preemptive right, is a right granted to a party giving him or her the first opportunity to purchase property if the owner decides to sell it. . . . [W]hen the property owner gives notice of his intent to sell, the preferential right matures . . . into an enforceable option.'") (quoting FWT, Inc. v. Haskin Wallace Mason Prop. Mgmt., L.L.P., 301 S.W.3d 787, 793 (Tex. App.—Fort Worth 2009, *pet. denied*)); *but see In re Robert L. Helms Constr. & Dev. Co., Inc.*, 139 F.3d at 706 ("Performance due only if the optionee chooses at his discretion to exercise the option doesn't count [for executory contract analysis] unless he has chosen to exercise it.").

193. *In re Riodizio, Inc.*, 204 B.R. at 423 ("Most courts . . . consider an option contract to be executory although they reach their conclusions through different routes."); *In re* Kellstrom Indus., 286 B.R. 833, 834–835 (Bankr. D. Del. 2002).

194. *In re* Abitibibowater, Inc., 418 B.R. 815, 830–31 (Bankr. D. Del. 2009) (noting that "[n]umerous other courts have determined that contingent option agreements are executory when material obligations will arise on each side if the option is exercised.").

Depending on the jurisdiction and applicable state law, the recording of a contract containing a preferential right to purchase or right of first refusal may make such right a covenant running with the land, thereby precluding a debtor's ability to reject it.[195] However, some courts, including the Fifth Circuit, have held that the recordation of an option, even where it concerns real property, will not convert the option into a real property interest that is insulated from rejection.[196]

C. Plan Sales

Sale transactions may also be effectuated pursuant to a plan of reorganization or liquidation. While energy asset sales pursuant to Bankruptcy Code § 363 can be advantageous to parties because they avoid the expense and delay inherent in the plan process, a sale under a Chapter 11 plan is more flexible, offers greater possibilities with respect to the sale, and may offer more benefits to the parties in the long run. For example, a plan may include compromises of claims and issuance of debt or equity securities, along with providing different consideration to different classes of claimants and interest holders.[197] Additionally, a sale pursuant to a plan of reorganization may be less likely to trigger preferential rights to purchase or rights of first refusal if structured as a merger transaction or an equity sale, the "synthetic plan sale" discussed further *infra*.[198]

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195. *See*, *e.g.*, *In re* Plascencia, 354 B.R. 774, 780 (Bankr. E.D. Va. 2006) ("Virginia . . . has changed the traditional rule, so that an option is in the 'nature of an interest in real estate which may be recorded and by that recordation protect the optionee's interest in the real estate.'") (quoting Springfield Eng'g Corp. v. Three Score Dev. Corp., 26 Va. Cir. 186, 191 (1992)).

196. Rivercity v. Herpel (*In re* Jackson Brewing Co.), 567 F.2d 618, 623–24 (5th Cir. 1978) (finding that a lower court had the authority to allow rejection of a recorded option); *see also In re* A.J. Lane & Co., 107 B.R. 435, 438 (Bankr. D. Mass. 1989) (noting that the option "is only a contract right—the right to purchase—whose remedy is normally specific performance [and t]hat the world is given notice of this right though its appearance in a recorded deed prevents any other buyer from claiming the equities of an innocent third party, but that is all").

197. *See*, *e.g.*, *In re* Tropicana Entm't, L.L.C., 2009 Bankr. LEXIS 5455, at *36–37 (Bankr. D. Del. May 5, 2009) (discussing resolution and compromise of disputed claims and interests); *In re* Simon, 2008 Bankr. LEXIS 2787, at *6–7 (Bankr. E.D. Va. July 29, 2008) (finding that, while Bankruptcy Code § 1122(a) requires that all claims in a class be substantially similar, it does not require that all substantially similar claims be placed within the same class, and "[i]f a plan proponent can articulate legitimate differences among otherwise substantially similar claims and if separate classification is in the best interest of creditors and will foster reorganization, then separate classification may be proper."); COLLIER ON BANKRUPTCY ¶ 1122.03[1][a].

198. However, parties should review the applicable contracts and leases to determine the triggers of any preferential rights to purchase, consent rights, or rights of first refusal.

Moreover, the Bankruptcy Code § 1145 securities registration exemption provides more flexibility to use securities as part of the consideration for the sale, although that exemption is not available as part of a sale outside of a plan under Bankruptcy Code § 363.[199] The securities registration exemption permits the exchange of the securities of a debtor (or a successor to the debtor) principally for claims against the debtor.[200] A third party buyer who does not have claims against the debtor may also rely on any applicable non-bankruptcy securities exemption, such as a private placement, to purchase securities from the debtor.[201]

Furthermore, a plan sale must meet the voting and plan confirmation requirements of the Bankruptcy Code.[202] Thus, creditors will have the benefits of disclosure and the plan voting and confirmation processes—benefits that do not apply to asset sales under Bankruptcy Code § 363. These plan confirmation requirements protect creditors and also provide greater flexibility and powers to debtors through the plan sale process.

Plan sales are intended to be final, and courts, utilizing the doctrine of "equitable mootness," are generally reluctant to "unscramble the eggs" in the event a party seeks to appeal the confirmation of a plan.[203] Developed by appellate courts, the equitable mootness doctrine supports the dismissal of appeals from final bankruptcy court orders under certain circumstances.[204] The doctrine emerged in order to constrain appeals and potential reversals of sales or plans to favor finality in the bankruptcy process.[205] In *Pacific Lumber*, the Fifth Circuit found that equitable mootness is "firmly rooted in Fifth Circuit jurisprudence" and that the court's job is to "strik[e] the proper balance between the equitable considerations of finality and good faith reliance on a judgment and competing interests that underlie the right of a party to seek

199. 11 U.S.C. §§ 1123(a)(5)(J), 1145, 1123(a)(5)(C) (2012).
200. 11 U.S.C. § 1145(a)(1)–(2).
201. 11 U.S.C. § 1126 (setting forth reorganization voting requirements); 11 U.S.C. § 1129(a) (outlining reorganization confirmation requirements).
202. 11 U.S.C. § 1129(a).
203. *See In re* Continental Airlines, 91 F.3d 553, 560–66 (3d Cir. 1996).
204. Bank of New York Trust Co., NA v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.)*,* 584 F.3d 229, 240 (5th Cir. 2009) ("This court accordingly considers '(1) whether a stay was obtained, (2) whether the plan has been 'substantially consummated,' and (3) whether the relief requested would affect either the rights of parties not before the court or the success of the plan.'") (quoting Manges v. Seattle-First Nat'l Bank (*In re* Manges), 29 F.3d 1034, 1039 (5th Cir. 1994)); *see also In re* Continental Airlines, 91 F.3d at 560 ("Factors that have been considered by courts in determining whether it would be equitable or prudential to reach the merits of a bankruptcy appeal include (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments.") (citing *In re* Manges, 29 F.3d at 1039; *In re* Public Serv. Co., 963 F.2d 469, 471-72 (1st Cir. 1992)).
205. *In re* Pac. Lumber Co., 584 F.3d at 240.

review of a bankruptcy order adversely affecting him."[206] Despite some criticism,[207] the doctrine of equitable mootness remains an important consideration in the plan sale process.

As discussed *infra*, parties seeking to consummate an energy sale by a plan of reorganization may select one of three primary options: (1) an asset sale; (2) a merger; or (3) a stock, or synthetic plan, sale. If parties are able to reach an agreement prior to the petition date, pre-packaged and pre-negotiated plans may be used to effectuate such sale structures.

1. Asset Sales and Mergers

Asset sales under plans of reorganization are similar to Bankruptcy Code § 363 sales in that they both enable a bankruptcy court to approve a transaction allowing a debtor to effectively sell its assets free and clear of liens, claims, and other encumbrances.

The Bankruptcy Code requires a plan of reorganization to "provide adequate means for the plan's implementation."[208] "Adequate means" includes the "transfer of all or any part of the property of the estate to one or more entities," the "merger or consolidation of the debtor with one or more persons," or the "sale of all or any part of the property of the estate."[209] Bankruptcy Code § 1123(a)(5)(C) permits the merger or consolidation of the debtor with "one or more persons" as part of the plan.[210] A "person" is defined to include a partnership or a corporation.[211] Accordingly, a debtor corporation may be merged with one or more other corporations under a plan of reorganization. Such mergers are expressly authorized under the Bankruptcy Code, rendering any other approval required by non-bankruptcy law unnecessary.

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206. *Id.* (quoting *In re* Manges, 29 F.3d. at 1039).
207. *In re* Continental Airlines, 91 F.3d at 569 (Alito, J., dissenting) ("Thus, as this case well illustrates, the doctrine of 'equitable mootness' is not really about 'mootness' at all in either the Article III or non-Article III sense. As the Seventh Circuit stated in a passage that the majority quotes with approval, 'there is a big difference between inability to alter the outcome (real mootness) and unwillingness to alter the outcome ('equitable mootness'). Using one word for two different concepts breeds confusion.'") (internal citations omitted); *see also In re* UNR Indus., Inc., 20 F.3d 766, 769 (7th Cir. 1994) (stating that "equitable mootness" is a misnomer and banished from the local lexicon in order to consider instead "whether it is prudent to upset the plan of reorganization at this late date").
208. 11 U.S.C. § 1123(a)(5) (2012).
209. 11 U.S.C. §§ 1123(a)(5)(B), (C) & (D).
210. 11 U.S.C. § 1123(a)(5)(C).
211. 11 U.S.C. § 101(41).

2. Synthetic Plan Sales

A plan of reorganization may also provide for a sale of equity interests in the reorganized debtor, often called a "synthetic plan sale." A synthetic plan sale process may be proposed as a mechanism for vesting properties of the bankruptcy estate free and clear of liens, claims, and encumbrances in a buyer. In a synthetic plan sale, equity interests in the reorganized debtor are issued to the purchaser, and any assets, liabilities, and claims not purchased are transferred to a liquidating trust.[212] A synthetic plan sale can often be structured in such a manner so as to avoid triggering preferential rights to purchase or rights of first refusal arising from actual asset transfers or contract assignments. Further protections are set forth in the plan's discharge and injunction provisions, which prohibit creditors from pursuing pre-confirmation claims against the buyer or the reorganized debtor owned by the buyer.[213]

3. Pre-Packaged Plans

A pre-packaged plan of reorganization offers an efficient method for effectuating a transfer under a plan. Unlike a conventional Chapter 11 plan that is negotiated post-bankruptcy, a "pre-packaged plan," or "prepack," is both negotiated and voted on before a debtor files for bankruptcy. Pre-packaged plans are commonly used when a sale transaction can be negotiated pre-bankruptcy; however, the parties to the sale must still invoke the powers of the bankruptcy process in order to bind non-consenting parties to the terms of the transaction.

Bankruptcy Code § 1121 allows a debtor to file a plan of reorganization simultaneously with its bankruptcy petition and seek confirmation of the plan based on the requisite number of votes cast pre-petition.[214] This expedited mechanism mitigates certain negative externalities which flow from a traditional Chapter 11 reorganization, including litigation costs, business disruption, negative publicity, turnover, and delays.[215] Furthermore, by enabling the case to proceed straight to confirmation, pre-packaged plans also minimize judicial involvement in the debtor's business affairs and operations.

While the benefits are plentiful, prepackaged plans come with a cost, in that general trade creditors must often be paid in full under the plan to be unimpaired. Unimpaired creditors are deemed to vote to accept a plan; their votes need not be solicited.[216] This unimpairment of trade creditors is important because, *inter alia*, soliciting votes from hundreds—if not

212. 11 U.S.C. §§ 1123(a)(5)(B), (a)(5)(D), & (b)(3)(B).
213. 11 U.S.C. § 1141.
214. 11 U.S.C. § 1121.
215. *See* Wachtell, *supra* note 98, at 41–42.
216. 11 U.S.C. §§ 1126(f), 1129(a)(8)(B).

thousands—of trade creditors outside of bankruptcy can present an extremely difficult task. Accordingly, by paying the general trade creditors the full value of their claims, a prospective debtor seeking to confirm a prepackaged plan need not obtain the trade creditors' consent, thereby increasing the chances of plan confirmation.

To obtain confirmation of a pre-packaged plan, a debtor must adhere to the procedural requirements set forth in the Bankruptcy Code, or else risk the bankruptcy court refusing to confirm the prepackaged plan. Denial of confirmation may occur for a number of reasons, including a finding by the bankruptcy court that the solicitation process was deficient.[217] Bankruptcy Code § 1126(b) pertinently provides that: (1) prepackaged Chapter 11 plan votes must have complied with any applicable non-bankruptcy law, rule, or regulation governing the adequacy of disclosure of vote solicitation; or (2) if there is no such law, rule, or regulation, votes on a pre-packaged Chapter 11 plan must have been solicited after disclosure of "adequate information," as defined in the Bankruptcy Code.[218] The Federal Rules of Bankruptcy Procedure also require timely transmission of the plan and other solicitation materials "to substantially all creditors and equity holders of the same class."[219]

If the pre-packaged plan provides for the offering of new securities, parties must also determine whether the offering of such new securities is exempt from the Securities Act registration requirements. Bankruptcy Code § 1145(a) provides a safe harbor for the issuance of new securities under a conventional plan of reorganization and exempts from registration "the offer or sale under a plan of a security of the debtor."[220] Whether this safe harbor exists with respect to pre-packaged plans, however, remains unclear because the Bankruptcy Code provides an exemption only for "a security of the debtor," and the issuer pursuant to a prepack is not a "debtor" until the filing of the bankruptcy petition. In light of the current state of the law surrounding an offering of securities pursuant to a pre-packaged plan, parties should err on the side of caution and file a registration statement with the SEC.

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217. *See, e.g.*, *In re* Southland Corp., 124 B.R. 211, 225 (Bankr. N.D. Tex. 1991) ("A proponent of a prepackaged plan takes a substantial risk that . . . the Court may determine that the proposed disclosure statement or process of solicitation are inadequate").

218. 11 U.S.C. § 1126(b). The disclosure statement sets forth the terms of the plan of reorganization and the procedures for voting thereon.

219. FED. R. BANKR. P. 3018(b). A safe minimum time period of voting on a pre-packaged plan is twenty-eight days. *See* Wachtell, *supra* note 98, at 44 (reasoning that twenty-eight days is a good rule of thumb because that is the minimum time specified in Bankruptcy Rule 2002(b) for considering a disclosure statement in bankruptcy).

220. 11 U.S.C. § 1145(a)(1).

4. *Pre-Negotiated Plans*

Like pre-packaged plans, pre-negotiated plans are negotiated before a debtor files for bankruptcy. However, unlike prepacks, voting on pre-negotiated plans does not occur until after a bankruptcy case is filed. As a result, pre-negotiated plans are generally subject to a marginally longer bankruptcy process. Nevertheless, they provide a significant advantage over prepacks in that the parties can obtain bankruptcy court approval of the solicitation process in advance, thereby reducing the risk of a flawed solicitation.

As with prepacks, pre-negotiated plans commonly minimize certain negative externalities that arise from out-of-court transactions and the conventional Chapter 11 process, such as litigation costs, business disruptions, administrative expenses, negative publicity, and fraudulent transfer risk. Moreover, pre-negotiated plans also allow parties to reduce judicial involvement in the debtor's business affairs.

While a full vetting of "lock-up agreements" is beyond the scope of this article, in an effort to secure a successful pre-negotiated plan, parties often enter into lock-up agreements to bind key constituencies to ensure they support the plan. A lock-up agreement (sometimes referred to as a "plan support agreement") is an agreement to accept and otherwise support a particular plan of reorganization. Lock-up agreements can provide significant protections, but they are not bulletproof and may be challenged if not appropriately structured.[221]

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221. *See, e.g.*, *In re* Innkeepers USA Trust, 442 B.R. 227, 232–36 (Bankr. S.D.N.Y. 2010) (denying debtor's motion to assume plan support agreement because, among other reasons, (1) the plan support agreement was not a disinterested business transaction, (2) the debtor did not enter into the plan support agreement with "due care," and (3) the debtor did not act in good faith in making the decision to enter into the plan support agreement and in providing transparency to their creditors).

CONCLUSION

While prospective purchasers of distressed energy assets have a range of options to effectuate their acquisition objectives, dealing in distressed energy assets can be complex and may involve various risks depending on the circumstances of each acquisition. As this article has shown, there are advantages and disadvantages to both out-of-court and in-court transactions, which should be evaluated by prospective purchasers with the assistance of their financial and legal advisors.

In the current environment for energy assets, there are risks and opportunities for sellers and buyers alike. The ability to transact will depend on available capital and understanding not only the business issues, but also the legal framework and processes that often come into play in distressed energy transactions.

APPENDIX

A. Key Fraudulent Transfer Cases

1. *Templeton v. O'Cheskey (In re Am. Hous. Found.)*, 785 F.3d 143 (5th Cir. Apr. 28, 2015), *as revised* (June 8, 2015).

A trustee brought actual and constructive fraudulent transfer claims pursuant to federal law to avoid and recover approximately $1 million in purportedly fraudulent transfers related to guaranties given by the debtor to the defendants and subsequent payments that the defendants received from the debtor as "returns" on their respective contributions to a limited partnership. While the lower court applied the good faith defense under Bankruptcy Code § 548(c), the Fifth Circuit found the lower court used the wrong "good faith" standard and reversed and remanded. The Fifth Circuit concluded that the lower court should not rely exclusively on its determination that a party's actions did not defraud other creditors, but should look further to whether the claimant should be on inquiry notice of the debtor's insolvency or the fraudulent nature of the transaction.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A), 548(a)(1)(B), 548(c).

2. *Janvey v. Golf Channel, Inc.*, 780 F.3d 641 (5th Cir. 2015).

A receiver overseeing an estate brought suit to recover $5.9 million from the Golf Channel relating to an advertising contract the estate had entered into before the SEC uncovered a Ponzi scheme. The lower court determined that although the estate's payments to the Golf Channel were actual fraudulent transfers under state law, the Golf Channel was entitled to judgment as a matter of law on its affirmative defense under TUFTA that it received the payments in good faith and in exchange for reasonably equivalent value (the market value of advertising on The Golf Channel). On review, the Fifth Circuit rejected the argument that "reasonably equivalent value" was exchanged and held that Golf Channel's services provided no value to the creditors of the estate, and, further, the advertising services did not provide even a speculative economic benefit to the creditors, regardless of the market value of the services. Thus, the Golf Channel's affirmative defense to an actual fraudulent transfer under TUFTA was not established.[222]

222. This TUFTA "*Erie*" ruling appears to conflict with the precedent set forth in *Williams v. FDIC* (*In re Positive Health Mgmt.*), 769 F.3d 899 (5th Cir. 2014), summarized *infra*, interpreting the analogous good-faith, for-value defense under Bankruptcy Code § 548(c), as looking to the value given from the viewpoint of the transferee.

Applicable Statute: TEX. BUS. & COM. CODE ANN. §§ 24.005(a)(1), 24.009(a) (2015).

3. *Williams v. FDIC (In re Positive Health Mgmt.)*, 769 F.3d 899 (5th Cir. 2014).

A trustee brought claims of actual and constructive fraudulent transfers under § 548 for rent payments made by the debtor to a lender on a loan that was made to another entity and secured by property that the debtor used for office space. The lower court held there was no constructive fraud since the debtor received reasonably equivalent value based on the value received for continuing operations without foreclosure and for a "reasonable rent" for the office space. While the lower court found actual fraud based on an "actual intent to hinder, delay or defraud" creditors, the lower court found that the affirmative defense of good faith, for value pursuant to Bankruptcy Code § 548(c) applied because the lender: (1) acted with good faith and (2) gave "value" in exchange for the payments. The Court relied on its prior holding in *In re Hannover Corp.*, 310 F.3d at 799-802, that value for purposes of the good faith, for value affirmative defense is considered from the transferee's perspective. The Fifth Circuit affirmed the good faith affirmative defense but only to the extent that the transferee gave value to the debtor in exchange for the transfer. The Fifth Circuit applied a "netting" approach, holding that Bankruptcy Code § 548(c) required the court to reduce the value of the fraudulent transfers by the value of the market rent, and to award the estate the difference.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A), 548(a)(1)(B), 548(c).

4. *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 503 B.R. 348 (Bankr. S.D.N.Y. 2014).

A parent company acquired the debtor entity by means of a leveraged buyout (LBO) in which the debtor company financed the entire purchase, taking on approximately $21 billion of secured indebtedness, of which $12.5 billion was paid out to stockholders of the then-debtor-to-be. The debtor company filed for bankruptcy thirteen months later, and when its creditors found themselves ranking behind the LBO secured lenders, the creditors filed actual and constructive fraudulent transfer claims under state law. The court held that: (1) the Bankruptcy Code § 546(e) defense did not apply to state law fraudulent transfer claims not asserted under any Bankruptcy Code provision, and state law fraudulent transfer claims are not preempted by the Bankruptcy Code; (2) where the transaction was collapsed and considered based upon economic substance, the transfers were deemed to be property of the debtor;

(3) nominee, non-beneficial holders of stock cannot be held liable for fraudulent transfers; (4) a creditor's trust cannot sue on behalf of creditors who ratified the transfers (but can sue on behalf of those who did not ratify); and (5) although evidence supporting allegations of actual fraud were deficient, the Court dismissed with leave to amend pleadings.

Applicable Statute: State Law, but the court cited no specific statute and noted that "[t]he particular state law is not relevant to these motions, if it ever will be. State fraudulent transfer law is largely, but not entirely, the same throughout the United States . . . ."]

5. *Tronox Inc. v. Kerr McGee Corp. (In re Tronox, Inc.)*, 503 B.R. 239 (Bankr. S.D.N.Y. 2013).

After a spinoff in 2006, the debtor retained substantial legacy, environmental, and tort liabilities that accrued over the course of seventy years, while the debtor's valuable oil and gas exploration and production business was transferred into a new entity. A few months after the spinoff, a third party purchased the newly-formed entity's recently acquired exploration and production business for $18 billion. The debtor subsequently filed for bankruptcy in 2009. Regarding actual fraud, the court found numerous "badges of fraud" and determined that the defendants lacked a good faith belief that the debtor would be able to support the liabilities that had been imposed on it after the spinoff. Thus, actual fraudulent intent to delay or hinder creditors was established under state law. Regarding constructive fraud, the court, after considering all related transactions together as a single transaction and analyzing market evidence, contingent liabilities, and asset valuation, held that the debtor did not receive "reasonably equivalent value" in the transaction. Based on numerous factors, the court found that the debtor was insolvent and unreasonably capitalized and that the defendants reasonably should have believed that the debtor would be unable to pay its debts as they became due. Thus, constructive fraud was also established under state law.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A), 548(a)(1)(B); Okla. Stat. tit. 24, §§ 116(A)(1), 116(A)(2), 117(A) (2015).

6. *Senior Transeastern Lenders v. Official Comm. of Unsecured Creditors* (*In re TOUSA, Inc.*), 680 F.3d 1298 (11th Cir. 2012).

A parent company paid a $421 million debt settlement to a third party transferee with the proceeds of a loan that was secured primarily by assets of the parent company's subsidiaries even though the subsidiaries were not obligors on the debt to the third party transferee. Six months later, the parent company and the subsidiaries declared bankruptcy. The Eleventh Circuit held that the bankruptcy court did not err when it found transfer of the liens to the new lenders was constructively fraudulent pursuant to Bankruptcy Code § 548(a)(1)(B) because the subsidiaries did not receive "reasonably equivalent value" for the liens. The Eleventh Circuit did not define "value" but did find that benefits to the parent and the corporate family did not necessarily convey value to the subsidiary.

Applicable Statute: 11 U.S.C. § 548(a)(1)(B).

7. *Kaye v. Lone Star Fund V (U.S.), L.P.*, 453 B.R. 645 (N.D. Tex. 2011).

A parent company spun-off a subsidiary, and the subsidiary sued for actual and constructive fraudulent transfers under both federal and state law. Specifically, the subsidiary alleged that the parent company transferred various financial burdens to the subsidiary in an effort to improve the parent company's marketability. In considering a motion to dismiss, the court ruled that constructive fraud was adequately pled based on proceeds flowing to the parent without reasonably equivalent value in return. With respect to actual fraud, the court found that the claim was adequately pled based on the following three badges of fraud: (1) transfers were to an insider, (2) the debtor received less than reasonably equivalent value, and (3) the debtor was insolvent.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A), 548(a)(1)(B); ALA. CODE §§ 8-9A-4(a), 8-9A-4(c), 8-9A-5(a) (2015).

8. *U.S. Bank Nat'l Assn. v. Verizon Commc'ns. Inc. (U.S. Bank Nat'l Assn. Litigation)*, 817 F. Supp. 2d 934 (N.D. Tex. 2011).

A parent company spun-off a subsidiary whose balance sheet reflected that its debt exceeded its assets by approximately $9 billion after the spinoff. The subsidiary subsequently filed for bankruptcy twenty-eight months later. The subsidiary's trust brought claims for actual and constructive fraudulent transfers under state and federal law. While the court found certain badges of fraud to be present, the court ultimately found that the subsidiary was solvent as of the date of the spinoff, that there was no direct evidence of fraudulent intent, and that there were insufficient badges of fraud as a matter of law to prove an actually fraudulent transfer. The constructive fraudulent transfer claims also failed, as the court found that there was no effective difference between the insolvency analysis and the reasonably equivalent value analysis, and, since the subsidiary was solvent based on total enterprise value, the subsidiary received reasonably equivalent value.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A) – (B); TEX. BUS. & COM. CODE ANN. §§ 24.005(a)(1) – (2).

9. *The Liquidation Trust v. Daimler AG (In re Old Carco LLC (f/k/a Chrysler LLC))*, 454 B.R. 38 (Bankr. S.D.N.Y. 2011).

A liquidation trust asserted fraudulent transfer claims based on a former parent company's alleged intention to strip valuable assets away from the debtor before selling its controlling interest in the debtor. The court found that the trust did not sufficiently take into account all elements of value received in the overall transaction and held that the constructive fraudulent conveyance claims under federal and state law were properly dismissed because of the trust's undervaluation and omission of various disputed consideration elements.

Applicable Statute: 11 U.S.C. § 548(a)(1)(B); N.Y. DEBT. & CRED. LAW § 273 (2015).

10. *ASARCO LLC v. Ams. Mining Corp.*, 396 B.R. 278 (S.D. Tex. 2008).

The debtor sued its parent corporation to challenge a transfer under which the parent company received valuable stock assets of the debtor. Regarding constructive fraud, the court looked to Delaware law and analyzed whether "reasonably equivalent value" was given in exchange for the asset. Upon completing its valuation, the court found that, under the totality of the circumstances, the debtor received eighty-five to ninety percent of the value of the asset, which constituted "reasonably equivalent value." As to actual fraud, the court found that the parent company did not properly market the stock to the highest bidder, removed the "crown jewel" asset from the estate, concealed information, broke promises, and closed the transaction over the objections of the independent directors with knowledge that the transaction would hinder and delay the debtor paying other creditors. Accordingly, the court found actual fraud and entered a judgment valued at over $6 billion against the parent company.

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A) –(B); 6 DEL. CODE ANN. tit 6, §§ 1304(a)(1) –(2) (2015), 1305(a) (2015).

11. *VFB LLC v. Campbell Soup Co.*, 482 F.3d 624 (3d Cir. 2007).

A parent company spun-off a subsidiary and sold it several food companies. The subsidiary financed the purchase by taking on new secured debt and issuing a dividend to the parent's shareholders upon the becoming an independent company. The subsidiary filed for bankruptcy within three years and sued the parent, asserting, *inter alia*, a constructively fraudulent transfer claim. The Third Circuit affirmed the lower court's rejection of the claim because (1) the food companies were worth well in excess of the amount the subsidiary paid for them at the time of the spin-off, (2) market valuation was sufficient to show the food companies were solvent at the time of the spin-off, and (3) "reasonably equivalent value" was exchanged.

Applicable Statute: N.J. STAT. ANN. §§ 25:2-25(b), 25:2-27(a) (2015).

12. *Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283 (Bankr. S.D.N.Y. 2007).

A creditors' committee brought suit to set aside transfers totaling approximately $3.7 billion from the debtor to its parent company during the four years leading up to the debtor's bankruptcy. At issue was whether certain transfers were voidable fraudulent transfers or preferences, with a focus on whether the debtor was either insolvent or inadequately capitalized at the time the challenged transfers were made. The court determined that the "voluminous and compelling" contemporaneous market value of the debtor's securities was consistent with "substantial enterprise value" and was "inconsistent with insolvency." The court further determined that looking back at the market with "hindsight bias" in valuing the entity for purposes of insolvency was inappropriate because "the public trading market constitutes an impartial gauge of investor confidence and remains the best and most unbiased measure of fair market value and, when available to the court, is the preferred standard of valuation." *Id.* at 293. The court held that the plaintiff had not carried its burden to prove either insolvency or unreasonably small capital and dismissed all fraudulent transfer claims.

Applicable Statute: 11 U.S.C. § 548(a)(1)(B); D.C. CODE § 28 –3102 (2015).

13. *Jimmy Swaggart Ministries v. Hayes* (*In re Hannover Corp.*), 310 F.3d 796 (5th Cir. 2002).

The trustee argued before the Fifth Circuit that the debtor's transfers to a third party under an option agreement for the purchase of real estate could be avoided as actual and constructive fraudulent conveyances under federal law. The district court had reversed the bankruptcy court's ruling that the transferee had taken the transfer in good faith and for value. The Fifth Circuit reversed the district court and found that the bankruptcy court was entitled to deference regarding its determination that the good faith, for value affirmative defense had been established under Bankruptcy Code § 548(c). The Fifth Circuit determined that the transferee acted in good faith and that (1) the call options had value from the perspective of the transferee, (2) the value was determined at the time of origination, and (3) the debtor's practical inability to exercise the option is irrelevant to its valuation for purposes of the good faith, for value affirmative defense under Bankruptcy Code § 548(c).

Applicable Statute: 11 U.S.C. §§ 548(a)(1)(A) – (B), 548(c).

B. Glossary of Commonly Used Chapter 11 Bankruptcy Terms

Note: The following definitions are provided to assist the reader in understanding some of the terms used in Chapter 11 proceedings generally. For more detailed and exact definitions, please review the Bankruptcy Code and consult with legal counsel.

Administrative Claims: Fees of court-authorized professionals, trustee's commissions, and claims of trade creditors and others for credit extended after the entry of the order for relief. Administrative claims generally are entitled to priority and must be paid before claims of any prepetition unsecured creditors.

Anti-Assignment Clause: A provision in a contract that restricts or prohibits the transfer or assignment of interests in an executory contract or unexpired lease.

Automatic Stay: When a Chapter 11 petition is filed, creditors are automatically prohibited from attempting to collect their prepetition claims from the debtor or proceeding against property of the debtor without first obtaining permission from the court to do so.

Cash Collateral: Cash and cash equivalents that serve as collateral for a secured creditor's claim. Included in this category are cash, bank deposits, proceeds from the sale of assets, accounts receivable collections, and rents.

Class of Creditors: Creditors must be divided into classes in a plan of reorganization. The claims of general unsecured creditors are frequently grouped together as one class, but there may exist sufficient distinctions among the general unsecured creditors that justify dividing them into multiple classes.

Confirmation: The approval by the court of a plan of reorganization.

Consensual Plan: A plan of reorganization accepted by every class of creditors and equity holders. It is rare for a consensual plan not to be approved by a bankruptcy court.

Conversion: The Bankruptcy Code, in general, allows a debtor to reorganize under Chapter 11 or to be liquidated under Chapter 7. A case may be changed, or converted, from administration under one chapter to administration under another by court order or upon the request of the debtor, any creditor, the United States Trustee, or any other party in interest. Creditors will often move to convert a Chapter 11 case to Chapter 7 if it does not appear that the debtor will be able to successfully reorganize, or if they think they would recover more in liquidation than under a reorganization.

Cramdown: Confirmation of a plan of reorganization over the objection of a class of creditors or equity holders. Cramdown may occur only if at least one class of creditors whose claims are impaired by the plan votes to accept it. The court will cramdown a plan on a dissenting class only if it finds that the plan does not discriminate unfairly against that class and is fair and equitable as to that class.

Debtor: The entity undergoing reorganization.

Debtor in Possession: Unless and until a trustee is appointed, a debtor remains in possession of its assets and will manage its own affairs. The debtor in possession has a fiduciary obligation to its creditors, much the same as a court-appointed trustee.

Discharge: The release of claims against the debtor.

Disclosure Statement: When creditors are solicited to vote on a plan, they will receive the plan or a plan summary (if approved by the court), a ballot, and a disclosure statement. The disclosure statement is intended to give creditors adequate information about the debtor and the plan to permit them to make an informed judgment as to whether to vote for or against the plan. The debtor cannot send the disclosure statement to creditors until it has been approved by the bankruptcy court, after notice and a hearing.

Examiner: A person appointed by the court, upon a motion of creditors or the United States Trustee, to look into the debtor's books and records and dealings with third parties. The scope of the examiner's duties are established by the court. The report prepared by the examiner is usually filed with the court and maintained as a public record.

Fraudulent Transfer (or Conveyance): Transfers or conveyances that are deemed to be in fraud of creditors, either actually or constructively, may be avoided under state law and/or the Bankruptcy Code by the debtor in possession or by the trustee.

General Unsecured Claims: Those unsecured claims that are neither administrative nor priority claims.

Involuntary Petition: Three or more creditors (or one creditor, if a debtor has fewer than twelve creditors) with undisputed, liquidated claims can put a debtor into bankruptcy by filing an involuntary petition if the debtor is not paying its debts generally as they become due. The bankruptcy court will give the debtor a chance to respond to the involuntary petition and then will hold a hearing on the involuntary petition. If the petitioning creditors prove their case, the bankruptcy court will enter an order for relief against the debtor.

Lockup Agreement: An agreement between parties that binds creditors or other parties to the terms of a negotiated restructuring that is a common feature of out-of-court pre-packaged workout plans.

Order for Relief: The declaration that the debtor's business is subject to the court's jurisdiction. In a voluntary case, an order for relief is automatically entered when the petition is filed. In an involuntary case, an order for relief can only be entered after giving the debtor the opportunity to defend the allegations in the petition.

Petition: The documents filed with the bankruptcy court that initiate a bankruptcy case.

Plan of Reorganization: Sometimes referred to by the shortened term "plan," the document that, when approved by the bankruptcy court, specifies the treatment of the claims of the debtor's creditors. A confirmed plan is binding on all creditors—even those who did not vote in favor of the plan. Where the debtor's assets are liquidated in a Chapter 11 case, this document will instead be called a plan of liquidation.

Preference: Payments made to creditors within 90 days prior to the filing of a petition on account of pre-existing debts may, under some circumstances, be avoided by the debtor in possession or trustee. The ninety-day period is extended to one year if the creditor is an insider of the debtor. A creditor's committee may be instrumental in pursuing preference claims, particularly preference claims against insiders of the debtor.

Preferential Rights: The rights provided to a third party by the terms of an executory contract or unexpired lease, which grant the party the first opportunity to purchase or assert some preference. Preferential rights are also known as rights of first refusal or preemptive rights.

Priority of Claims: Prepetition unsecured claims that are entitled to be paid before the claims of the general unsecured creditors. The most common priority claims are for wages, employee benefits, customer deposits, and taxes.

Proof of Claim: The document filed with the bankruptcy court by a creditor that establishes the amount and basis of its claim.

Rule 2004 Examination: A procedure, similar to a deposition, for obtaining information from the debtor and third parties about the assets and liabilities of the debtor and other matters relevant to a case. The party being examined is asked questions under oath before a stenographer, who prepares a written transcript of the examination. The party may also be required to produce documents relevant to the case.

Schedules: A document filed with the bankruptcy court by a debtor setting forth its assets and liabilities in detail.

Section 341 Hearing: Commonly referred to as the first meeting of creditors, the debtor appears at an informal hearing, which, in a Chapter 11 case, is conducted by the United States Trustee. All creditors are entitled to ask the debtor questions about its business, its assets and liabilities, and other matters relevant to the reorganization.

Secured Creditor: A creditor whose claim is backed by collateral.

Solvency (or Valuation) Opinion: A third party expert opinion that evaluates assets or transactions with a distressed company.

Statement of Financial Affairs: A document filed with the bankruptcy court by a debtor that sets forth certain information about the debtor's business, management, and finances. The statement of financial affairs is normally filed simultaneously with the schedules.

Super-Priority Administrative Claim: A type of administrative claim that has priority over other administrative claims. Super-priority administrative claim status is often granted to a secured lender in connection with a cash collateral or borrowing stipulation.

Trustee: A person who may be appointed by the United States Trustee, who is entrusted with the responsibility of managing the debtor's business, pursuing claims against third parties, and maximizing the payment to creditors through a reorganization or, if appropriate, a liquidation of the business. In a Chapter 11 case, a trustee is appointed only upon court order after motion by a creditor, the United States Trustee, or another party in interest. Grounds for appointment of a trustee include fraud, dishonesty, or gross mismanagement by the debtor.

United States Trustee: An officer of the United States Department of Justice responsible for monitoring Chapter 11 cases. The *United States Trustee* is responsible for appointing trustees and presiding at the Section 341 hearing. The *United States Trustee* has the right to be heard on any matter coming before the bankruptcy court and to file motions with the bankruptcy court in furtherance of its duties.

Voluntary Petition: A petition filed by the debtor. Most Chapter 11 cases are commenced by the filing of a voluntary petition.