

# The Do's and Don'ts of §363 Sales

Continuing Legal Education for the Mississippi  
Bankruptcy Conference

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# The §363 Sale – Overview

- Governed by 11 U.S.C. §363
- Sale of assets 'free and clear' of liens, claims, encumbrances
- Requires notice & court approval
- Often faster and more certain than a plan process
- Most chapter 11 cases are headed here, not reorganization (possible exception is sub-V cases)

# Do's & Don'ts of the Process

## Do:

- Market assets broadly & transparently
- Obtain clear bid procedures order
- Communicate with secured creditors, creditors' committee & U.S. Trustee (including weekly written reports)
- Document process and good faith purchaser protections

## Don't:

- Rush process without marketing
- Over-favor insiders
- Eliminate competitors from process out of hand
- Give exclusivity or chase a single suitor solution

# Perspectives of the Parties

## “What’s in it for me?”

- Debtor: Maximize value, Speed, Certainty, Preserve going concern value
- Shareholders: Preserve legacy, jobs, and future employment, Minimize personal guarantee issues, Hoping for recovery
- Secured Creditors: Protect collateral, Maximize value, Get certain outcome, Transparent process
- Unsecured Creditors: Preserve going concern (or out of the money), Some recovery, More time, Ongoing customer, Transparency/a voice
- Buyers: Certainty of title, Clarity on Executory contracts, Preservation of value via speed
- Court/U.S. Trustee: Transparency & process integrity, Broader view of maximizing recovery for ALL Parties-In-Interest

# Advisors – FA vs. IB

## Services (Fees)

- Financial Advisor (FA): Restructuring strategy, Valuation, DIP negotiation, Cost cutting, Credible cash management and reporting for creditors (typically charges weekly/monthly fee, or can be hourly, plus expenses)
- Investment Banker (IB): Runs sale process (usually broad), Sources buyers and lenders, Negotiates bids, Conducts auction, Facilitates diligence, Solves problems and sees it through, Communicates with Parties-In-Interest throughout to ensure transparency, trust, buy-in, Some “FA light” work (most compensation is success fee, some retainers)
- Broker: Often used in single-asset or real estate-heavy cases and smaller cases, Less positioning/sophistication than IB, Likely cannot provide financial modeling (may do success fee plus expenses)

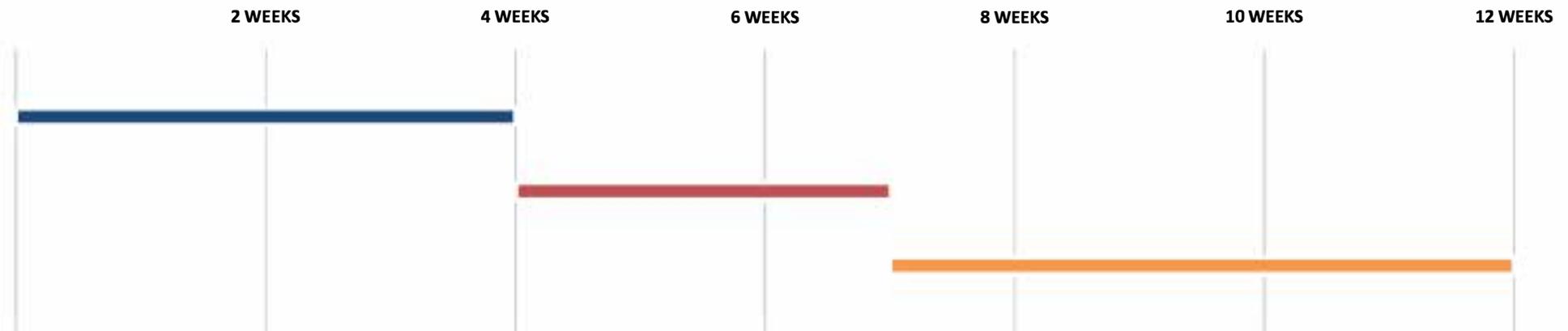
# Retention of IB/FA

- IB: Governed by §§ 327, 328, Rule 2014
- IB: Preferably not subjected to §§ 330, 331 (reasonableness, time keeping, fee application), but only to the last sentence of 328(a); FA: likely is subject to these
- Must be 'disinterested'
- Full disclosure of connections required
- Court must approve compensation structure
- IB: Final fee can sometimes be included in a sale order; FA: Needs to file fee app

# Sale Process Description

- Select professionals with experience in c11 (industry experience is usually less important)
- Understand the business and value drivers, determine what is going to be sold, and position in the most positive light to each buyer audience
- Establish reasonable timeline and milestones to fit circumstances
- Broad outreach – not just the most likely buyers
- Move prospective bidders through process on same timing:
  - NDAs – CIM – Dataroom – Management Meetings – Offers
- Select Stalking Horse (or not)
- Additional due diligence and bid deadline
- Auction - of Qualified Bidders only, no contingencies (the auction can utilize “open outcry”, “sealed bid”, and/or other methods)
- Sale Hearing – important to have testimony regarding the sale process (actual or proffered)
- Closing – typically 15 days, when the sale order is non-appealable (may be sooner if appeal is waived pursuant to Good Faith Finding, §363(m))

# Illustrative Expedited Timeline



## **■ Weeks 0-4**

- > Develop Marketing Materials, Initial Outreach
- > Provide CIM and Access to VDR
- > Initial Buyer Due Diligence Calls

## **■ Weeks 4-7**

- > Request Initial Term Sheets / Offers
- > Management Meetings / Site Visits
- > Negotiate / Request Revised and Improved Term Sheets / Offers

## **■ Weeks 7-12**

- > Term Sheet Acceptance or Stalking Horse Process
- > Closing

# Common Pitfalls

- Insufficient marketing / rushed sale
- Management attempting to control process and limit buyer pool or access to information, “steering” to a favored buyer in self interest
- Weak bid procedures order
- Unclear treatment of executory contracts
- Overly generous stalking horse protections
- Choosing a poor stalking horse and / or establishing artificially high and/or contingent bid to beat
- Business deterioration
- Liquidity
- Loss of confidence of creditors
- Judging offers before they are fully baked and / or tested by auction

# Common Pitfalls- Bid Procedures

- Arbitrary timeline, milestones that don't match liquidity or other constraints
- Lack of clear instructions for bidders
- Unclear or unequal treatment of executory contracts
- Restrictive bid lots
- Wrong or restrictive bid increments
- Deposits – too low/ too high (lack of staging)
- Overly generous or stingy stalking horse protections
- Stalking horse “deadline” vs “may select by” date
- Lack of Backup Bid mechanism
- Chilling language regarding minimum bid / credit bidding rights
- Lack of flexibility in general

# Real Estate Sales – Unique Characteristics

- Broker retention more common, especially if not income producing
- Valuation challenges, zoning, environmental risks
- Often more public information available to establish value
- Lease assumption/rejection issues
- Longer diligence cycles vs. typical distressed M&A
- Unlike a going concern, may not be a “melting ice cube”, resulting in less pressure for speed, higher probability of a credit bid

# Free and Clear Sales

- 11 U.S.C. §363(f) allows 'free and clear' sale
- Buyer takes assets without liens/claims (subject to exceptions)
- Common objections: Successor liability, adequate protection of lienholders, sub rosa plan

# Credit Bidding

- Right under §363(k), unless subject to a bona fide dispute
- Protects secured lenders (sets floor price)
- Can chill competitive bidding

# Executory Contracts & Leases

- Governed by §365
- Must cure defaults & provide adequate assurance of future performance
- Licenses treated differently
- Hypothetical vs. Actual Test

# Stalking Horse Bidder

- Pros: Sets baseline value for auction, Provides certainty to all constituents (helping to preserve the going concern value), Encourages competitive bidding
- Cons: May chill additional bidding, Expense/breakup fees scrutinized by courts, Potential reduction in proceeds

# Late and Disgruntled Bidders

- Balance between maximizing value and integrity of process
- Standing generally limited to 'person aggrieved'
- Unsuccessful bidders often lack standing absent showing of direct harm
- Push risk to the late contingent bidder via deposit or surety bond

# DIP Financing – Current Market

- Private credit funds, hedge funds more active in larger DIP loans
- Smaller DIP loans are harder to come by, and are expensive
- Most often, in recent years, the DIP lender will be a party with an existing interest in the case (secured creditor, customer, potential buyer, insiders) – there are a variety of reasons, other than economic return of the loan, to be a DIP lender
- Higher pricing, tighter covenants in 2025
- Roll-ups & milestones increasingly common
- DIP often dictates sale timeline / milestones

# Final Takeaways – Do's & Don'ts

- Do: Engage advisors early, Build consensus with creditors, Market broadly and transparently, Plan ahead for objections and likely business and legal challenges
- Don't: Overpromise (\$ recovery, timing of payment, stalking horse protections), Neglect DIP financing deadlines, Cut corners on disclosure or marketing, Rely on a single solution

# Common Mistakes for Troubled Companies

- Denial –“What Problem?”
- Delay/Paralysis –“I know I have a problem, but...I’m paralyzed, or I’m waiting for the magical turnaround”
- Lack of Transparency –“I can’t let my lender find out...”
- Over promising / premature promising on debt repayment agreements
- Single Suitor –“This specific investor (or this bank, or this buyer) is interested”
- Failure to preserve value in IP, employees, key customer
- Operating in survival mode, managing checkbook, failing to manage the business
- Borrowing via stretching key vendors, or worse, payroll tax
- Merchant Cash Advances
- Funding losses with new equity -“good money after bad”

# Signs an IB or FA is Needed

- Working capital concerns
- Eroding margins
- Loss of major customer
- Supply chain and/or labor issues choking business
- Borrowing via stretching key vendors, Merchant Cash Advances, or worse, payroll tax
- Loan term expiring
- Technical or covenant default / Forbearance
- Judgements / Litigation