

Bankruptcy Section 363 Sales: Buyers Beware of "Free and Clear" Sales of Non-debtor Subsidiaries

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The sale of corporate assets under Section 363 of the Bankruptcy Code is often a key element of the bankruptcy process. Under Section 363(f), a bankruptcy trustee or debtor-in-possession may sell the bankruptcy estate's assets "free and clear of any interest in such property." The "free and clear" provision provides a means for the debtor to consummate the sale quickly, as competing interests in the property need not be resolved as a condition to the sale. Section 363 sales are also attractive to buyers who thereby obtain protection from successor liability, subject to certain exceptions.

When a corporate parent is a debtor in bankruptcy, the shares of the debtor's subsidiaries are also "assets" that may be sold under Section 363. But a recent case from the US Bankruptcy Court for the District of Delaware, *In re Insilco*, is a cautionary reminder to buyers that a stock sale is still a stock sale, and that a buyer who takes the shares of a corporation under a 363 order will still be responsible for the subsidiary's indebtedness. *Amphenol Corp. v. Shandler (In re Insilco Technologies, Inc.)*, Adv. Proc. No. 05-52403 (Bankr. D. Del. Sept. 18, 2006).

Prior to filing for bankruptcy, Insilco Technologies, Inc. (Insilco) struck a deal with Amphenol Corporation (Amphenol) to sell Amphenol certain assets of two of Insilco's subsidiaries as well as all of the stock in its wholly owned subsidiary, Precision Cable Mfg. Co., Inc. (PCM). Amphenol in turn agreed to act as a "stalking horse" buyer for the assets and stock, subject to a bankruptcy court's Section 363 order authorizing the sale free and clear of all interests. Insilco and certain of its subsidiaries (excluding PCM) then filed for bankruptcy protection under Chapter 11 and sought approval for the sale from the bankruptcy court, subject to competitive bids.

Ultimately, the bankruptcy court entered an order approving the sale to Amphenol. The bankruptcy court Sale Order stated, pursuant to Section 363(f), that the assets and PCM stock were transferred to Amphenol, "free and clear of any and all liens, security interests, encumbrances and claims . . . [and that] the Buyers shall not assume or become liable for any Interests relating to the Purchased Assets and the Shares Being Sold by the Sellers." Amphenol paid \$10 million for the purchased assets and PCM stock. The Chapter 11 case was subsequently turned over to a liquidating trustee under a Chapter 11 liquidating plan.

Two years later, the liquidating trustee filed a preference action for more than \$1 million against

PCM, which had become a subsidiary of Amphenol. PCM had been paid during the preference period for goods and services provided to Insilco and Insilco's other subsidiaries. Amphenol attempted to dispute the preference action on the basis that the Sale Order enjoined the liquidating trustee from pursuing claims against the assets and stock transferred pursuant to that order. The bankruptcy court agreed that its Sale Order had an injunctive effect, but noted that the only property transferred under the Sale Order was (1) the assets of Insilco's co-debtor subsidiaries, and (2) Insilco's equity rights as sole shareholder of PCM. Both the co-debtor assets and the PCM stock were indeed sold free and clear of interests—but PCM's assets were not. As PCM's assets were not transferred under the Sale Order, that order did not enjoin the pursuit of claims or interests against PCM or its assets.

The obvious but critical point is that a stock sale of a non-debtor subsidiary "free and clear" in fact offers very limited protection to the buyer. In buying a corporation—not merely its assets—under Section 363, a buyer does not receive any discharge or protection from the corporation's indebtedness. The bankruptcy court found that PCM, following the stock sale to Amphenol, remained subject to the \$1 million preference claim by the liquidating trustee.

Implications

Amphenol believed that the bankruptcy court order, under the authority of Section 363(f), protected it from claims or liability related to the purchase of PCM, except for the specific liabilities assumed in the sale agreement. Based on its affidavits, if Amphenol had understood that a \$1 million contingent liability was attached to the transaction, it would not have paid \$10 million to Insilco. In the end, Amphenol did not get the benefit of the bargain that it had made, and the beneficiaries of the liquidating trust (the creditors of Insilco) were allowed to seek a double payment for the same asset (first a payment in the Section 363 sale, then a payment in the preference action). *In re Insilco* reminds buyers not to rely on Section 363(f) protections in bankruptcy transactions involving stock sales of non-debtor subsidiaries.

Before purchasing a debtor's stock in a non-debtor subsidiary, a buyer should conduct due diligence as to all of the company's indebtedness, ranging from trade debt to bankruptcy and non-bankruptcy actions that may exist against the non-debtor subsidiary—and should discount the offering price accordingly. Alternatively, if the only material causes of action are claims held by the parent corporation's bankruptcy estate, a buyer might demand as a condition to the transaction that the subsidiary receive a release of any and all actions that the bankruptcy estate may have against it. Of course, the need for such extra precautions only arises in Section 363 sales of *stock* in *non-debtor* subsidiaries, as Section 363 sales of *assets* of *co-debtor* subsidiaries, by their structure, convey the co-debtor's assets "free and clear."

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