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by Cass S. Weil

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Section 363 of the Bankruptcy Code – A Tool for Buying and Selling Financially Distressed Assets

By Cass S. Weil | 612.877.5327 | Cass.Weil@lawmoss.com

Consider these common "distressed asset" scenarios: A business only has capital to operate for a short time. A lender or potential purchaser is willing to provide only short-term financing to a struggling business. A potential purchaser says that it will pay more for assets if it can acquire the assets "free and clear" of existing liens and interests and be assured that the sale will not be set aside by a court. A quick transaction may preserve the value of business assets, including relationships and employee loyalty, but there is resistance from one or more constituent groups.

In each of the foregoing circumstances, the provisions of Section 363 of the Bankruptcy Code may provide a useful tool for accomplishing objectives of both buyers and sellers. Since the changes to the Bankruptcy Code in 2005, sales of assets of businesses of all sizes pursuant to Section 363 of the Bankruptcy Code, as opposed to reorganization and restructuring through the full process of Chapter 11, have become increasingly popular as a method by which buyers and sellers transfer financially distressed assets.

A Section 363 sale is a procedure by which debtors can fulfill their fiduciary obligations to creditors and ownership by maximizing value and minimizing transaction costs. Purchasers get enhanced value by proceeding quickly in often deteriorating circumstances and obtaining the protections afforded by a sale "free and clear" of preexisting liens and interests, as well as enhanced finality compared to sales outside of bankruptcy.

What is a "Section 363" Sale?

"Section 363" refers to the portion of the Bankruptcy Code that authorizes a debtor to sell its assets "outside the ordinary course of business." Sales of assets "outside the ordinary course of business" are sales that are either dissimilar to the sales that the debtor would engage in as part of its day-to-day operations or different from the type of transactions that the debtor typically engaged in before it sought bankruptcy protection. A Section 363 sale transfers the debtor's assets to a buyer in a discrete transaction that will be approved by the bankruptcy court if the debtor can demonstrate a "substantial business justification" for the sale. Unlike a full Chapter 11, a Section 363 sale does not require the debtor to propose and gain acceptance of an overall plan of reorganization before the sale can be consummated. In fact, debtors' cases can be converted to liquidations after consummation of the Section 363 sale.

Advantages of Section 363 Sales

Because it can be accomplished quickly, the sale of a debtor's assets under Section 363 requires less cash or credit to keep the

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Protecting Vulnerable Adults

By Cindy J. Ackerman | 612.877.5330 | Cindy.Ackerman@lawmoss.com

By 2050, the number of people age 65 years and older will double, and the population of those age 85 years and older will nearly quadruple. As baby boomers are becoming senior citizens, financial exploitation and abuse of vulnerable adults is on the rise. For example, in 2010, older Americans lost at least $2.9 billion to financial exploitation, a 12% increase from the $2.6 billion in losses estimated in 2008. Unfortunately, for each reported case of financial exploitation, an estimated 42 other cases go unreported.

Over the past few years, the Minnesota legislature has enacted several safeguards designed to strengthen the protections for vulnerable adults. These safeguards include, among other things, changes to the power of attorney statute and refinements to the Minnesota Vulnerable Adults Act.

Statutory Short Form Power of Attorney

When a vulnerable adult is no longer able to manage his or her finances, court involvement may be necessary to appoint an agent to manage the finances. To avoid the expense and delay of a court action, an individual (the "principal") may use a Statutory Short Form Power of Attorney to appoint an attorney-in-fact (the "agent") to manage his or her finances when he or she is no longer able to do so.

Under Minnesota law, a principal may confer upon an agent either limited or general authority to act on the principal's behalf. An agent granted all of the powers in a Statutory Short Form Power of Attorney has full control over the principal's assets. Although full control enables the agent to properly manage the principal's assets, it also could leave the principal vulnerable to financial exploitation.

The Minnesota legislature recently added safeguards to the power of attorney statute to help prevent financial exploitation of vulnerable adults who use a Statutory Short Form Power of Attorney. First, the statute was changed to clarify the persons who can seek court action to protect the principal's assets when controlled by an agent acting under a power of attorney. Effective August 1, 2013, and applicable to all Statutory Short Form Powers of Attorney, regardless of the date of execution, the principal or any interested person (e.g., guardian, conservator, legal representative, spouse, parent, adult child, sibling, attorney for the principal, or health care agent) may petition the court for a protective order directing the agent to provide an accounting or for other relief, such as the appointment of a conservator.

Second, the statute was changed to require the principal to name specifically the agents who have the authority to make gifts of the principal's assets to the agent or the agent's dependents. The amount that an agent may gift to himself or herself, or his or her dependents, has been changed from a fixed $10,000 to an amount equal to the then-current federal gift tax annual exclusion ($14,000 in 2013). If the principal does not specifically authorize the agent to make such gifts, the agent continues to have the power to make gifts to anyone other than the agent or the agent's dependents.

Finally, some misuse of the Statutory Short Form Power of Attorney occurs simply because the agent does not understand his or her duties and obligations when managing the assets of another. The Minnesota legislature adopted a new form "Statutory Short Form Power of Attorney," effective January 1, 2014, that identifies an agent's duties and obligations to:

(1) act with the interests of the principal utmost in mind;

(2) exercise the power in the same manner as an ordinarily prudent person of discretion and intelligence would exercise in the management of the person's own affairs;

(3) render accountings as directed by the principal or whenever the agent reimburses himself or herself for expenditures made on behalf of the principal;

(4) act in good faith in the best interests of the principal, using due care, competence, and diligence;

(5) cease acting on behalf of the principal if the agent learns of any event that terminates the power of attorney or the agent's authority under the power of attorney, such as revocation by the principal of the power of attorney, the death of the principal, or the dissolution of the agent's marriage to the principal; and

(6) disclose his or her identity as an attorney-in-fact whenever the agent acts for the principal by signing in substantially the following manner:

(Signature), "as attorney in fact for (name of principal)," or

(Signature), "(name of principal) by (name of the attorney-in-fact), the principal's attorney-in-fact."

The new form requires the agent to acknowledge affirmatively that he or she has read the Statutory Short Form Power of Attorney and understands it.

While the new Statutory Short Form Power of Attorney will not prevent intentional misuse of a principal's trust by an unscrupulous agent, it may prevent unintentional misuse by an uninformed agent.

Minnesota Vulnerable Adults Act

The Minnesota Vulnerable Adults Act expresses the State of Minnesota's policy to protect adults who, because of physical or mental disability or dependency on institutional services, are vulnerable to maltreatment and financial exploitation. The Act applies to anyone in a fiduciary relationship who has the duty to act

on behalf of someone else, such as an attorney-in-fact, a trustee, or a conservator.

For example, a child managing his or her parent's assets under a Statutory Short Form Power of Attorney has a fiduciary duty to manage the parent's assets as an ordinarily prudent person of discretion and intelligence would manage his or her own assets. It is not enough for the child to manage the parent's assets in the same manner as the parent managed his or her own assets. The child must act in the best interests of the parent.

Children acting as agents for their parents sometimes run afoul of the Vulnerable Adults Act by using their parents assets for their own personal benefit. For example, a child of an incapacitated parent might use the parent's funds to purchase a home for the child and the parent to reside in. If the child titles the home in his or her own name, the child has now converted the parent's asset to the child's asset, which is an action of financial exploitation that can result in criminal and civil penalties against the child.

Last year, the Minnesota legislature strengthened the criminal penalties for financial exploitation of vulnerable adults. At the same time, in honor of World Elder Abuse Awareness Day, the Hennepin County Attorney's Office announced that it was stepping up prosecutions of crimes against the elderly, primarily those crimes based on financial exploitation and willful neglect. The maximum sentence for criminal financial exploitation is 20 years imprisonment and a fine of up to $100,000. Effective August 1, 2013, the courts may consider the aggregated value of what the exploiter received within any six-month period when sentencing the exploiter for criminal financial exploitation. Also effective August 1, 2013, all offenses committed, regardless of the county where the offense took place, may be prosecuted together. The legislature extended the statute of limitations for criminal prosecution of financial exploitation for losses exceeding $35,000 to five years.

To encourage financial institutions to report suspected financial exploitation, the law was changed to clarify a financial institution's immunity from legal challenges when it reports suspected abuse in good faith. In addition, to assist in the recovery of assets converted by an alleged exploiter, the Minnesota Vulnerable Adults Act provides the vulnerable adult with a civil cause of action against the alleged exploiter. The vulnerable adult may recover civil damages equal to the greater of three times the amount exploited or $10,000, plus reasonable attorney's fees and costs.

Protecting Vulnerable Adults in Care Facilities

In addition to the risks of financial exploitation, the elderly in care facilities are particularly vulnerable to maltreatment. The State of Minnesota Compliance Monitoring Division has an obligation to investigate complaints against care facilities regarding the care and treatment of vulnerable adults. Too often, family members of vulnerable adults are excluded from this process. This year, to address this issue, the Minnesota legislature amended an existing law to require the Commissioner of Health to interview at least one family member of the vulnerable adult during the investigation. If the vulnerable adult or the person making the complaint expressly requests that no family member be interviewed, the request must be included in the investigative file.

Conclusion

The Minnesota legislature continues to strengthen the laws to protect vulnerable adults from financial exploitation and abuse, and government and financial institutions continue to educate and develop policies to protect vulnerable adults. Even so, the best protection may be for an individual to plan proactively for incapacity by selecting appropriate agents and developing a team of trusted advisors before the need arises.

Cindy Ackerman is a member of our wealth preservation and estate planning team. She represents clients in the areas of estate planning, charitable gift planning, tax strategy planning and compliance, tax-exempt organizations, probate and trust administration, elder law, and guardianships and conservatorships. Cindy can be reached at 612.877.5330 or Cindy.Ackerman@lawmoss.com.

Moss & Barnett Remembers Paul Van Valkenburg

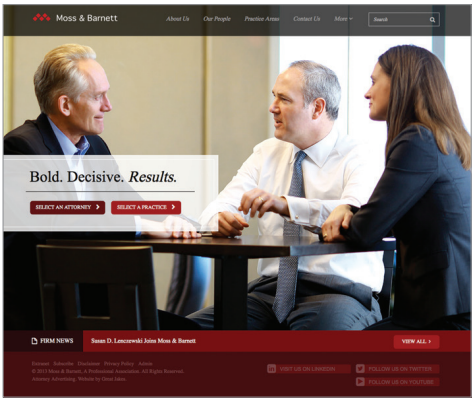
Long-time Moss & Barnett attorney, **Paul Van Valkenburg**, passed away peacefully at Episcopal Church Homes on June 25, 2013, at the age of 79. Paul enjoyed a distinguished career as an attorney for more than four decades, also blazing a parallel path of quiet service to the community and devotion to his family. "Paul was a gentle and friendly soul who enjoyed a wide-ranging legal practice, who was supported by loyal clients, and who made a difference in the community and several bar associations through his generous contributions of his time and talent," said Moss & Barnett President and Chief Executive Officer, Tom Shroyer. Paul is the inspiration and the namesake of Moss & Barnett's annual recognition for community service, the **Paul Van Valkenburg Community Service Award**.

Paul Van Valkenburg

Moss & Barnett Launches New Website

We are excited to announce the launch of our new website – **www.LawMoss.com**. A fresh, bold design, simple search and navigation features, greater resources, and more in-depth information highlight our new online home.

Our new site allows visitors easy access to attorney biographical information, legal-specific podcasts and blogs, radio programs, video clips, legal news and articles, and future events, with the option to share that information across social networking sites. We utilized a system platform that includes next-generation features for site search and content management, and we have deployed a new technology called "responsive web design" so that our new site is easily accessible to you – wherever and whenever you need to reach us – from your smartphone, tablet, laptop, or desktop. We are also expanding our reach through social media. Visitors will now find us on **LinkedIn**, **Twitter**, **YouTube** – and soon on **Facebook.**



Home page of the new Moss & Barnett website – www.LawMoss.com

We invite you to explore our new site and add us to your favorites list. Check out the pages for your attorneys and their practice areas; listen to, read, and view our thought leadership content; learn more about us, including our history, strategic alliances, and community involvement; and link to us on social media and join in the discussion. It is our goal to continually provide you with the information and content you desire, so please let us know of any other features, information, and content that you would like to see.

Moss & Barnett to Move in August 2014

We are pleased to announce that the firm has agreed to a long-term lease commencing in August 2014 for space in the Fifth Street Towers located at 150 South Fifth Street in downtown Minneapolis. The move to Fifth Street Towers will allow the firm to design space that is better suited to the way law firms now operate. We designed our existing space over 25 years ago, when we had a much higher ratio of support staff to attorneys, when commercial use of the Internet was just a rumor, and when there was little opportunity for lawyers to work remotely. Technology has permanently changed our workflow and reduced space needs. The firm will use 30% less space while providing the same level of excellent service to our clients. We expect that the favorable terms of this new lease will provide a strong foundation for continued success. Please stay tuned for future updates regarding our upcoming move.

Fifth Street Towers

Attorney Susan Lenczewski Joins the Team

We are pleased to announce that **Susan Lenczewski** has joined our business law and wealth preservation and estate planning teams. Susan focuses her practice on employee benefits and executive compensation, with an emphasis on employee stock ownership plans (ESOPs) and other tax-qualified retirement plans. She is an active participant in The ESOP Association (TEA) and the National Center for Employee Ownership, where she serves on the Board of Directors and was past chair of its Legislative & Regulatory Advisory Committee. Susan is a frequent presenter and has published numerous articles on ESOP topics. She comes to Moss & Barnett after 12 years as a shareholder in another Minneapolis-based law firm and six years as in-house counsel with an energy company. Susan received her J.D. from the University of Minnesota Law School and her B.A. from the University of Minnesota-Duluth.

Welcome to the team Susan!

Susan Lenczewski

Cecilia Ray To Chair Real Estate Team

We are pleased to announce that **Cecilia Ray** has been appointed the new chair of our real estate team. She has nearly 30 years of experience advising clients in business transactions and works with clients to support their business operations in the areas of telecommunications law, utility regulation, commercial real estate, and general corporate and business law. Her experience includes negotiating and drafting agreements for business operations, acquisitions, sales, and leases; advising businesses in structuring transactions and contract terms; working with lenders and borrowers involved in complex commercial financing transactions; and representing public utilities and telecommunications service providers in regulatory proceedings.

We offer our thanks to Cecilia for taking on this important responsibility for our firm!

Cecilia Ray

Jim Vedder Selected to Serve on Hennepin County Bar Association's Board of Directors

We are pleased to announce that **Jim Vedder** has recently been selected to serve on the Hennepin County Bar Association's Board of Directors. The Hennepin County Bar Association exists to serve the needs of its membership by advancing professionalism, ethical conduct, diversity, competence, practice development, and collegiality in the legal profession. Jim is a member of Moss & Barnett's family law team and assists clients in all aspects of family law, including the resolution and settlement of the division of marital and non-marital assets, spousal maintenance, child support, and custody issues. Jim joins Moss & Barnett's **Susan Rhode** on the HCBA Board and continues our law firm's tradition of service to the bar association.

Congratulations, Jim, and thank you (Jim and Susan) for your service to the legal community!

Jim Vedder

Your Business as a House

By Jeffrey S. Waldron | 612.877.5288 | Jeff.Waldron@lawmoss.com

The wise man builds his house on the rock, but the foolish man builds his house on sand. The rain will come down, the streams will rise, and the winds will blow and beat against that house; yet it will not fall, because it had its foundation on the rock.

In a lot of ways, a business is like a house. For each, shortcuts, inadequate planning, and poor maintenance can cause significant problems. The legal elements and procedures involved in establishing a business can be complex and confusing. The analogy to a house provides a simple framework to help clarify the roles of various documents in forming the business and maintaining its legal structure.

For example, for a corporation:

- The Articles of Incorporation establish the corporate existence. Like the foundation and framework of a house, the Articles contain the basic, defining characteristics of the business.
- The Bylaws function like the internal systems of a house, such as the electrical and plumbing systems. The Bylaws set forth the rules and practices under which the corporation self-regulates.
- The Control Agreement's role in a corporation is analogous to house rules for the occupants, defining the shareholders' rights to control the business and their economic relationship to it.
- The Buy-Sell Agreement establishes the points of ingress and egress. Like the doors of a house, the Buy-Sell Agreement controls exits from the business.
- The corporation's liability shield functions like a roof over the business, keeping its occupants safe from the elements. With careful planning and regular maintenance, this "roof" protects shareholders from personal liability for the debts and liabilities of the business.

1. Foundation = Articles

The Articles of Incorporation typically include the following:

- The company's name and registered office and agent for service of legal process.
- The classes of stock and the number of shares that the corporation has the authority to issue.
- The names of the corporation's initial board of directors.
- The limitations on director liability to the corporation or its shareholders.
- Whether and to what extent the board or the shareholders may take action in writing in lieu of a meeting.
- Special defining characteristics, such as preemptive rights or cumulative voting.

Just like laying the foundation of a house, forming an entity may seem conceptually simple, but there are traps for the unwary that can result in significant problems. For example, an organizer who forms an entity but fails to properly transfer authority to the company's new board of directors renders the corporation unable to take any legal action. This problem can be difficult and expensive to fix, particularly after the corporation has attracted investors, obtained bank financing, or been sold to a third party. In addition, the problem might cause the corporation's liability shield to fail.

Maintenance Items

- Keep the corporation's registered office and agent up to date to ensure that the corporation receives prompt notice of legal, tax, and other matters.
- Adjust the classes and authorized shares of stock, as needed, to help prevent disruptive and expensive challenges to stock ownership.

2. Internal Systems = Bylaws

The Bylaws primarily:

- Establish the authority and duties of the corporation's officers and directors.
- Govern the process for shareholder and board meetings, including notice, attendance, and frequency requirements.
- Establish the required books and records of the corporation.
- Set forth the corporation's indemnification obligations to officers and directors.
- Establish procedures for electing or removing officers and directors.

A properly utilized, thorough, and cohesive governance system avoids "faulty wires" and, potentially, costly fires. For example, consider a circumstance where an action requiring shareholder approval does not have unanimous support. The Bylaws set forth the procedures for calling a meeting on the action, giving notice to shareholders, and conducting the meeting. Adhering to those procedures helps ensure that any action or inaction is not subject to challenge by a dissenter due to procedural failures. Moreover, following the proper procedures when making decisions helps insulate directors from claims that, by action or inaction, they breached their duty of care to the corporation.

Jeff Waldron is a member of our business law and wealth preservation and estate planning teams. He assists companies in all phases of the business life cycle, including formation, operation, acquisition, and succession, and advises clients on a variety of matters, including contract drafting and analysis, tax planning, corporate governance, and other general business issues. Jeff can be reached at 612.877.5288 or Jeff.Waldron@lawmoss.com.

Maintenance Items

- Review the procedures set forth in the Bylaws regularly to ensure that the corporation is functioning properly.
- Take action by calling meetings or executing written actions when necessary in accordance with the procedures set forth in the Bylaws.
- Amend the Bylaws as needed for changes in business operations.

3. House Rules = Control Agreement

A Control Agreement can be utilized for various purposes, including:

- Establishing special voting or governance items, such as veto or board representation rights.
- Establishing economic agreements among the owners, such as when and how distributions are made.
- Setting forth confidentiality and non-compete obligations.
- Providing for additional contributions by shareholders, including the conditions under which such contributions can be required.
- Setting forth terms and conditions for admitting additional shareholders.

- Establishing other specific agreements between the shareholders.

Anyone who has ever had roommates quickly learns the importance of living together under clearly established expectations and guidelines. The Control Agreement is used to customize shareholder governance and economic relationships. Unlike the Bylaws, the Control Agreement must be agreed to by all shareholders, including anyone who has signed a subscription or contribution agreement. Amendments to a Control Agreement typically require unanimous approval.

A Control Agreement is binding on all shareholders, including all persons who subsequently become shareholders, but only if they have knowledge of the existence of the Control Agreement. The best practice is to have a new shareholder expressly agree to be bound by its terms. A Control Agreement is not enforceable against a new shareholder who has not signed it and is not aware that it exists. For that reason, a Control Agreement must be filed with the corporate records, and the corporation's stock certificates must include a notation indicating that a Control Agreement exists.

Due to the flexibility available with an LLC, a Control Agreement is especially important. A corporate structure is more rigid, thus a Control Agreement may not be necessary unless the owners have specific guidelines they want to establish.

Maintenance Items

- Communicate the Control Agreement's control provisions to all shareholders.
- Review the Control Agreement regularly to ensure that the shareholders understand corporate governance and economic matters.
- Amend the Control Agreement as necessary to delete, modify, or add control provisions.

4. Ingress and Egress = Buy-Sell Agreement

The Buy-Sell Agreement addresses the ways to exit a business, each highly customizable based on the desires of the parties:

- When and how shareholders can transfer their ownership interests.
- The events that will give rise to an option or an obligation by shareholders or the company to purchase a shareholder's interest. Typical triggering events are death, a proposed transfer to a third party, and involuntary transfer events, such as bankruptcy. If the shareholders are actively involved in the business, disability and termination of employment may be desirable triggering events for a buyout.
- The purchase terms in the event of an option. Specifically, a Buy-Sell Agreement will include provisions for determining the purchase price. Different approaches include a pre-agreed value that is updated on an annual basis, an appraisal, a formula, or some combination of these.
- The Buy-Sell Agreement can also include more tailored provisions, including rights of minority shareholders to participate in a sale of the business by the majority, or forced sale provisions in the event a shareholder wants to exit the company.

In a business, it is crucial to clearly establish how a shareholder exits the company, whether voluntarily or involuntarily. The failure to clearly establish exit procedures on the front end may result in shareholders punching their way out of the business, or being squeezed or forced out. Without clear procedures, exits can be messy and expensive.

When moving into a house with roommates, one knows them, may trust them, and likely wants to live with them – but not necessarily with their families or their creditors. A properly drafted Buy-Sell Agreement also prevents shareholders from being forced into a business relationship with someone through death, bankruptcy, or voluntary transfer.

Maintenance Items

- Review the Buy-Sell Agreement regularly for events that trigger a purchase option or obligation and the procedures that apply to such events.
- Review any purchase price formulas to ensure that the business's operations or financial structure has not changed in such a way to render the formula obsolete or unworkable to determine true value.
- Coordinate insurance coverage with buy-out obligations.

5. Roof = Liability Shield

If the roof of a house is not properly installed and maintained, it will spring a leak, causing much damage to the interior. The roof of a corporation is the liability shield, which protects the owners from the rough winds of operating an active business.

When determining whether to pierce the liability shield of a corporation, among other things, courts consider whether corporate formalities, such as abiding by the Bylaws, have been observed; whether adequate corporate records are being kept; and whether shareholders treat the corporation as a separate entity from their personal affairs. If a corporation is not properly designed and maintained, the liability shield will fail, exposing shareholders to personal liability for the business's debts and liabilities. This can be disastrous.

Maintenance Items

- Always use the full legal name of the corporation including, for example, "Inc." or "Corp.," or use a validly registered assumed name. This puts the world on notice that your entity has a liability shield in place.
- Hold meetings or execute written actions, as appropriate, to re-elect directors and officers annually.
- Authorize or ratify any distributions in a written action affirming that the corporation has sufficient assets to pay its debts after making the distribution.
- Ensure that assets used in the business are properly titled in the name of the business. Related entities utilizing the same assets or personnel should do so by agreement. The key to preserving the liability shield is to treat related companies as separate businesses from each other and from the owners.
- For actions outside of the ordinary course of business, consult with legal counsel as to whether resolutions of the board or the shareholders are appropriate.
- Understand and observe the procedures established under the Bylaws and the Control Agreement.
- Keep good corporate records showing a clear delineation among the shareholders, the business, and any related businesses.

This article focuses on corporations, although the analogy to a house is useful for virtually any type of business entity. A business with a solid foundation and regular maintenance is a business built to last.

ALERT: Criminal Record Inquiries

Your current employment application may need to be revised by January 1, 2014, to avoid a violation of new "Ban the Box" legislation affecting private employers in Minnesota.

Effective January 1, 2014, private employers in Minnesota cannot inquire into or require disclosure of a job applicant's criminal record or criminal history until the applicant has been selected for an interview or, if there is no interview process, has been given a conditional offer of employment. The common practice of requesting applicants to check a box if they have been convicted of a crime and provide an explanation, and other methods of inquiring about criminal convictions, must be discontinued by most employers.

The new law, which is the result of the expansion of an existing law that applied only to public employers, does not apply to employers who have a statutory duty to conduct a criminal background check or otherwise take into consideration a potential employee's criminal history during the hiring process. Employers are still permitted to conduct criminal record checks, but they may not ask about criminal records or history on the application or conduct the background check until the interview or offer stage.

ALERT: Taxes Are On The Rise

The Minnesota Legislature recently enacted the Omnibus Tax Bill, which significantly increases certain taxes and creates new taxes, in addition to the recent federal tax increases. Key provisions of the Omnibus Tax Bill include the following:

Income Tax:
The Omnibus Tax Bill raises the Minnesota individual income tax rate starting January 1, 2013, by 2%, from 7.85% to 9.85%, on taxable income in excess of $150,000 for single taxpayers and $250,000 for married taxpayers who file a joint return. This is in addition to the 2013 federal individual income tax rate increases, including a 4.6% increase in the top federal individual income tax rate and the reinstatement of the phase out of itemized deductions and personal exemptions. The phase out of itemized deductions alone can effectively decrease the value of state tax deductions, charitable contributions, and certain other itemized deductions by up to 80%. In addition to the above increases, the new 3.8% federal health care tax is applicable to net investment income and other passive income. High income individual taxpayers, especially charitably inclined taxpayers, may see an effective increase in their tax rates of well over 10%.

Gift Tax:
The Omnibus Tax Bill creates a new gift tax effective for gifts made after June 30, 2013. The Minnesota gift tax will be 10% of the value of gifts in excess of the federal gift tax annual exclusion amount ($14,000 for 2013). A lifetime credit in the amount of $100,000 will be allowed, which is the equivalent of $1 million in value of gifts. Minnesota taxable gifts exclude the transfer of (i) real estate located outside of Minnesota; (ii) tangible personal property normally kept outside of Minnesota; and (iii) intangible personal property owned by a non-resident of Minnesota.

Estate Tax:
Effective January 1, 2013, gifts made within three years of death will be subject to Minnesota estate tax.

Also effective January 1, 2013, real estate and tangible personal property located in Minnesota and held by a non-resident of Minnesota in a pass-through entity will be subject to Minnesota estate tax. For example, if a building located in Minnesota is held by a limited liability company owned by a non-resident, the value of the building will now be subject to Minnesota estate tax.

Cigarette Tax:
The Omnibus Tax Bill increases the tax on a pack of cigarettes from $1.23 to $2.83, an increase of $1.60 per pack.

If you would like assistance in assuring best practices in either of these areas, please contact your attorney at Moss & Barnett.

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debtor's business going to preserve the value of assets by, among other things, maintaining uninterrupted business relationships and retaining employees, than would be required for a non-bankruptcy sale process or Chapter 11 reorganization. Typically, Section 363 sales can be accomplished in 60 to 90 days. Under the appropriate circumstances, however, the time from the bankruptcy filing through completion of a sale can be much shorter. A well-known example is the liquidation of Lehman Brothers Holdings, Inc., in 2008. The debtor's assets, valued at approximately $639 billion dollars, were sold to Barclays within five days of the bankruptcy filing. Other notable examples of rapid sales of substantial amounts of assets in a short time include General Motors and Chrysler.

Section 363 permits the sale of assets "free and clear" of existing liens and interests. Another notable benefit is that the bankruptcy court approves the purchase price as fair consideration for the acquired assets, thus minimizing the chance that the sale will be challenged as a fraudulent transfer or that the purchaser will incur successor liability. Section 363(m) protects Section 363 sales made "in good faith" from reversal on appeal unless the court stays implementation of the sale order while the appeal is pending. Section 363(m) provides a degree of finality unavailable outside of bankruptcy. The provision essentially moots the ability of any party to appeal a sale order once the sale has closed. When Section 363(m) is considered in conjunction with a sale "free and clear," the allure of Section 363 sales to potential purchasers becomes very clear.

Finally, Section 363 allows a debtor to assign to the purchaser or a third party favorable unexpired leases and executory contracts (contracts unperformed by both parties), but does not require the purchaser to assume the debtor's obligations under less attractive contracts. For example, a buyer can acquire a brand and production facilities along with ongoing sales contracts without assuming a union contract with employees. The ability to selectively transfer contracts is one of the most attractive facets of a full Chapter 11 reorganization that can be accomplished through a Section 363 sale, without having to satisfy Chapter 11's voting and solicitation requirements.

Because of these benefits, some buyers may be willing to pay more for assets acquired with the protections offered by Section 363. More often, buyers may be unwilling to buy distressed assets without Section 363 sale protections.

Limitations of Section 363 Sales

Section 363 sales cannot be used to "short circuit" the reorganization process set out in detail in Chapter 11 by altering creditor rights or by providing releases beyond the typical terms applicable to a buyer of assets. Courts have struggled to differentiate between allowable Section 363 sales and disguised reorganization plans. For example, in an early Section 363 case, the Fifth Circuit Court of Appeals, in *Pension Benefit Guaranty Corp. v. Braniff Airways, Inc.*, refused to approve a Section 363 sale because the proposed sale, which would have transferred ownership of Braniff Airways' cash, airplanes, and terminal leases, significantly restructured the rights of its creditors and provided for-profit participation in the new company, essentially amounting to a backdoor reorganization effort. Careful consideration of the nature and extent of relief to be sought in addition to the sale of assets in light of emerging case law is a necessary step in deciding whether a Section 363 sale is a viable alternative.

A feature of the Section 363 sale process that gives pause to some potential purchasers is that it takes place in the relatively transparent atmosphere of a bankruptcy case. Although protection of sensitive information is possible, the public nature of the proceedings must be balanced against the advantages noted above.

Another limitation on Section 363 sales is provided by Section 363(f)(3), which allows sales of assets "free and clear" of all liens as long as the price at which the assets are sold is greater than the aggregate value of all liens on the property. In other words, it is not possible to sell debtor's assets free and clear of "underwater" liens without the underwater lien holders' consent. If the lien is subject to "*bona fide* dispute," however, Section 363(f)(4) permits the sale of property subject to the disputed lien over the objections of the secured party.

The Section 363 Sale Process

Because both potential buyers and sellers intend to proceed rapidly once the seller/debtor files for bankruptcy, careful and thorough planning in advance of initiating bankruptcy is necessary. Because Section 363 sales are often undertaken at the behest of a creditor or potential purchaser who is supplying the debtor with cash to continue to operate, the potential purchaser or creditor will often have completed its "due diligence" in advance of the bankruptcy filing. The initiating party often serves as the initial bidder for the debtor's assets. The initial bid establishes a floor price for the assets to be sold. The initial bidder is called a "stalking horse." In addition to establishing the floor price and ensuring that there is at least one bidder for the assets, the stalking horse negotiates a form asset purchase agreement that can be shopped around to other potential bidders.

To protect the stalking horse bidder if it does not become the successful purchaser of the assets, many Section 363 sales agreements contain provision for a "breakup fee," which is a specified amount to be paid to the stalking horse in the event that it is not the winning bidder. The amount of the "breakup fee" must be approved by the bankruptcy court. The bankruptcy court will apply either a "business judgment" test or a "necessary to preserve the value of the estate" test to determine whether to approve a breakup

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fee. Under the "business judgment" test, breakup fees are presumably valid, and the court simply asks whether there was reasonable basis for the breakup fee and whether the amount was established in good faith and with due care. Under the "necessary to preserve" test, the court must find that the breakup fee actually benefited the estate by inducing or preserving the stalking horse bid. The test that the court will apply varies, but, under either formulation, courts will generally approve a breakup fee of two to four percent of the initial purchase price.

The identification of a stalking horse bidder and negotiation of a form asset purchase agreement is just the first step in the process. The debtor must not only apply to the bankruptcy court for approval of the stalking horse bid, form of asset purchase agreement, and the breakup fee, but must also obtain approval of bidding procedures for soliciting higher and better offers. This is typically accomplished through a sales procedures motion. The sales procedures will specify, among other things, the auction time and place, the extent and manner of the notice to be given of the auction, the deadline for qualified bidders to submit bids, and the deadline for any objections to the sale. To gain approval of the sale procedures, the court and interested parties must be convinced that the sale procedures are designed to ensure a fair and competitive bidding process that maximizes the value of the assets to be sold. Other interested parties, such as secured creditors and the unsecured creditors committee, are typically engaged in negotiations about the terms of the sale procedures motion. They will get notice of the proposed sales procedures and have an opportunity to object. For that reason, having prior agreement to the proposed procedures is preferable.

Once a stalking horse bidder has stepped forward and the sales procedures have been approved by the court, other qualified bidders are afforded the opportunity to submit bids. The sales procedures order will specify where and how information about the opportunity to bid on the assets offered for sale will be made available. The order will also define who may be a "qualified bidder" and what constitutes a "qualified bid." Generally, a "qualified bidder" is an entity that is willing and financially able to submit an irrevocable offer, in the form of a "marked up" version of the stalking horse's purchase agreement, that is greater than the amount of the stalking horse's bid. The sales procedure order will specify the increment by which a "qualified bid" must exceed the stalking horse bid. To minimize the possibility of a bidder's default, a common requirement for a qualified bid is evidence of the bidder's financial ability to perform, payment of a deposit, or both.

Many Section 363 sales garner no bids beyond the stalking horse bid. However, it is not uncommon for there to be more than one qualified bidder. When there is more than one bidder, the assets are sold at auction. In structuring the auction, care should be taken that bidding procedures are clear, that such essential items as the time and place for submitting bids, minimum bids, and bidding increments are specified, and that the method for evaluating competing bids is understood.

Interested parties, including the debtor, the debtor's creditors, and potential purchasers should all participate in formulating the sales procedures order to avoid any misunderstandings. Because bids can be in the form of cash, credit for existing liens, equity in the reorganized entity, or equity in the bidding entity, a method for comparing the value of bids containing differing proportions of the various allowed "currencies" is important. Failure to reach prior agreement on this issue can result in delay and a significant increase in transaction costs. A case involving the Polaroid Corporation serves as an example of what can happen if the parties do not agree on a procedure for determining the "highest and best" bid. In the *Polaroid* case, two bidders each proposed to fund a purchase through a combination of cash and equity in a reorganized debtor. The debtor and the unsecured creditors committee could not agree which bid was worth more. After the debtor declared a winner under the sale procedures order, the unsecured creditors committee contested the approval of the winning bid, arguing that the equity portion of the bid that was rejected by the debtor had to be evaluated differently from the equity portion of the bid chosen as the winner by the debtor. The bankruptcy court ultimately upheld the unsecured creditors committee's argument, observing that, because the committee members would be the future equity holders, the committee's preference should control. The dispute over which bid was the "highest and best" added significantly to the cost of the proceeding.

Final Thoughts

A Section 363 sale is a valuable tool for anyone considering the sale or acquisition of financially distressed assets. With careful advance planning that makes use of experienced and knowledgeable financial advisors and legal counsel, a transaction that maximizes value for both buyers and sellers can be structured in many cases. Unlike a sale outside of bankruptcy, a Section 363 sale can maximize the value received for the debtor's assets through a swift transaction that gives the successful purchaser assurances of finality and freedom from claims by existing creditors. Maximizing the value of the debtor's assets fulfills management's and the debtor's fiduciary obligations to creditors. The acquiring party in a Section 363 sale gets the benefits of a speedily completed transaction and the added protections afforded by Section 363(m).

The efficacy of Section 363 sales is demonstrated by their growing popularity and their use in such iconic cases as *General Motors*, *Chrysler*, *Polaroid*, and *Kodak*. To take advantage of Section 363 sales, seek the advice of experienced financial advisors and attorneys.

Cass Weil is a senior member of our creditors' remedies and bankruptcy team. He is the only Minnesota attorney to be certified in both consumer and business bankruptcy law. He counsels creditors and other participants in all phases of bankruptcy, reorganization, and commercial litigation. He can be reached at 612.877.5327 or Cass.Weil@lawmoss.com.

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* Moss & Barnett is especially pleased to congratulate **Susan C. Rhode**, who ranked in the Minnesota Top 100 and Top 50 Women *Super Lawyers* for 2013.

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Did You Know?

Joe Van Sloun, a paralegal with our litigation team, in his capacity as Executive Director of The Van Sloun Foundation, recently donated the entire amount needed to fund one of the very first K-9 protective vests in the State of Minnesota. The protective vest is now being worn by a Brooklyn Park police dog named Ozzy, a two and one-half year old Belgian Malinois. The Van Sloun Foundation's donation was made through Vested Interest in K-9s, Inc., an organization dedicated to providing protective vests to K-9 dogs.

Joe and his wife, Benita, will be donating another vest shortly to Officer Mike Running and his German Shepherd, Sammy, of the South Saint Paul Police Department. Sammy became South St. Paul's newest K-9 on June 7, 2012, when Officer Running and Sammy graduated from Washington County Sheriff Canine Training School.

The Van Sloun Foundation supports other canine and dog assistance programs, including Guiding Eyes for the Blind and America's Vet Dogs, which provides assistance dogs to returning veterans who were severely wounded in Iraq or Afghanistan.

The Van Sloun Foundation was established in 1991 in Massachusetts by Joe's uncle and aunt, Neil and Sue Van Sloun, and provides grants to over 35 organizations annually. The Foundation supports established and developing charities in the veterinary and medical sciences, botanical and horticultural development, land conservation, and education. Besides giving to several organizations around the country, the Foundation directly supports the following organizations in Minnesota and Wisconsin:

- Minnesota Landscape Arboretum
- Landscape Plant Development Center
- Minnesota Land Trust
- Minnesota-based projects with Ducks Unlimited
- University of Minnesota Cancer Research Center
- University of Minnesota Raptor Center
- Faith's Lodge

To view the March 28, 2013 Fox 9 News story regarding The Van Sloun Foundation's donation to Ozzy, visit Joe's bio on our website, **www.LawMoss.com**, or go to our YouTube channel, **www.YouTube.com/MossandBarnett**.

Brooklyn Park Police Officer Mike Ploumen,
Brooklyn Park Police K-9 Ozzy,
Moss & Barnett paralegal Joe Van Sloun