

## When Things Do Not Go As Planned In A Bankruptcy Sale

Law360, New York (October 29, 2014, 10:08 AM ET) -- Buying distressed assets is big business. Many distressed assets are acquired through the seller's Chapter 11 bankruptcy case. In those instances, a buyer will enter into a purchase and sale agreement with the seller/debtor, and the agreement is generally subject to notice and opportunity for overbids by third parties and ultimate bankruptcy court approval.

The somewhat problematic issue is determining what rights or obligations, if any, do the parties have under the agreement between the date of execution and the date the court enters an order approving the sale. This is precisely the issue the parties encountered in the Chapter 11 bankruptcy case of Hot Dog on a Stick, which is pending before the U.S. Bankruptcy Court for the Central District of California.



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Hot Dog on a Stick is a somewhat iconic fast food restaurant that opened in Southern California in the 1940s. However, because it is extremely difficult for any restaurant to thrive for an extended period, let alone for seven decades, HDOS encountered financial difficulties and had to file Chapter 11. After determining that a sale would be its most effective exit strategy, HDOS entered into a purchase and sale agreement (PSA) with LB Advisors. LB thus became the stalking horse, agreeing to purchase the debtor's assets for \$10 million in cash and equity valued by HDOS at an additional \$6 million, subject to overbid at auction.

The PSA required HDOS to file a motion seeking approval of sale procedures and another motion seeking approval of the sale. The negotiated sale procedures included a "breakup fee" provision in favor of LB such that if there was a successful overbid at the auction from a third party, and thus LB was not the winning bidder, HDOS would have to pay LB a \$648,000 breakup fee.

At a case status conference, the bankruptcy court and the creditors committee expressed certain concerns about the PSA. The parties attempted to negotiate a modified PSA in order to address the creditors committee's concerns. For reasons that are in dispute among the parties, HDOS elected instead to enter into a new agreement with another buyer, Global Franchise Group, and sought court approval of sales procedures with GFG as the stalking horse. Over the objection of LB, the bankruptcy court approved GFG as the stalking horse.

LB, unhappy with the process, sent a letter to HDOS purporting to terminate the PSA based upon the debtor's alleged defaults, and chose not to overbid. The sale to GFG was approved

and closed. LB then filed a motion seeking allowance of a claim for alleged damages against HDOS for breach of the PSA in the amount of \$24 million (its expected profits if the sale to LB had closed).

Alternatively, LB sought allowance and payment of its breakup fee, as an administrative expense of the estate, or in the alternative, as a general unsecured claim. The creditors committee opposed the motion. The issue before the court was the one raised at the outset of this article: What rights did the parties — in this case, the aggrieved original buyer, LB — have under the PSA before the PSA was approved by the court?

The likelihood that a court would award a multimillion dollar breach of contract award under these circumstances is very low. However, with respect to the sought-after breakup fee, both parties have very reasonable arguments in their favor.

On the one hand, the creditors committee's position is that the PSA is subject to court approval and was never approved. Therefore, LB had no rights under the agreement and thus no breach of contract claim can arise. At oral argument, counsel for the creditors committee made the committee's position very clear: "unfortunately stalking horses or proposed stalking horses are caught in a little bit of a bind. From the date they file their motion to get approved until the date of the hearing, they are exposed. That's part of the process."

On the other hand, LB argued that execution of the PSA had to have some binding effect on the parties even before court approval. For instance, the PSA required HDOS to meet deadlines for filing a sale procedures motion and a sale approval motion, and to return LB's deposit if approvals were not obtained by established dates. LB argued that these obligations had to mean something, especially when coupled with LB's obligation to submit a substantial good-faith deposit prior to any court approval. At a minimum, LB argued that HDOS was obligated to proceed with the motion to approve LB as a stalking horse and not enter into a new agreement with a different buyer unless and until the bankruptcy court rejected LB as the stalking horse.

Clearly, there is a tension between these two positions. If the creditors committee is correct, then why is the buyer obligated to submit its good-faith deposit? Presumably the creditors committee would say that such a provision is enforceable immediately. Or perhaps the creditors committee would say that the PSA essentially creates an option in favor of the debtor, who can prosecute the motion or not at its discretion. On the other hand, if LB is correct that certain obligations are immediately enforceable even prior to court approval, then does this create a breach of contract action against the seller/debtor?

The case law on this issue is very sparse. Therefore, this would have been a very interesting opportunity to make new law. However, as so often happens, the parties settled their dispute, with the bankruptcy estate agreeing to pay \$250,000 to LB and the parties exchanging mutual releases.

The next time you are involved in one of these bankruptcy sale transactions, no matter whether it is as buyer or seller, this case is a reminder that it is worth thinking carefully about the language of your purchase and sale agreement, taking steps to ensure that sale procedures are approved quickly, and considering obtaining the approval of the creditors committee at the very outset whenever possible. If things do not go as planned, you do not want to be left holding the stick.

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