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Practical tips for buying real estate in bankruptcy - part 2 of 2

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* A number of steps in the process (the initial hearing on approval of the stalking horse bid and the bidding procedures, the auction, and the hearing on approval of the winning bid) present opportunities for aggressive parties interested in the property to disrupt the proceedings to their advantage.

* Finally, a 363 sale is typically an "as-is" sale with no post-closing recourse against the bankruptcy estate. The combination of a limited opportunity to conduct due diligence with an as-is sale presents a higher level of risk than most buyers would prefer.

Issues Arising in 363 Sales of Real Estate

A number of issues frequently arise in connection with 363 sales involving real estate. These include:

Scope of Interests Extinguished by the Sale Order: Although Section 363(f) generally authorizes the bankruptcy court to sell assets free and clear of "any interest", courts generally agree that in order to sell free and clear of a particular lien, encumbrance or other interest, the trustee or DIP must give the holder of that interest notice of the proposed sale and an opportunity to object. The trustee's or DIP's counsel will sometimes try to dismiss this concern, but the careful buyer will want to ensure that at a minimum, the record clearly reflects that the holder of each known claim or interest was given notice of the proposed sale and an opportunity to object. In addition, the buyer may not want to extinguish certain interests (for example, an electrical easement in favor of the power company). The buyer should be sure to except these interests from the sale order so that they are not inadvertently extinguished.

Compliance with Laws: While the bankruptcy court can sell free and clear of interests, this does not excuse the buyer from continued compliance with all applicable laws and regulations. This distinction frequently arises in connection with environmental matters. Even if a sale order provides that property is to be transferred free of all environmental claims, the buyer may (and in most cases would) have the responsibility to address any existing environmental problems on the property, even if the buyer did not cause those problems. This reinforces the need for careful due diligence notwithstanding the accelerated schedule that most 363 sales have.

Conclusion

The 363 sale process presents a number of unusual opportunities and challenges. A prospective buyer of real estate in a 363 sale should get bankruptcy and real estate counsel involved as early in the process as possible. Understanding the advantages and potential pitfalls of this complicated, fast-moving process can put the buyer in a position to use the process to its advantage.

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