It would be an understatement to say that 2017 has been a difficult year for the retail sector. Store closings and bankruptcy filings punctuate the news almost daily. However, challenges beget opportunities, and this situation is no different. Here is why.

The bankruptcy process often presents an extraordinary opportunity to acquire the plum assets of the bankrupt company, known as the debtor. These assets can be very valuable to the debtor's competitors and other strategic investors. Some of the potential items on the block may be the debtor's accounts, inventory, customer lists, intellectual property, contracts, real property and leasehold interests.

Why buy assets from a bankrupt company? Buying assets through bankruptcy is advantageous because, under most circumstances, a buyer may obtain a court order approving a sale free and clear of all liens, claims, interests and encumbrances. In other words, a sale without baggage. *Tell me more!*

Business, Not As Usual = An Opportunity

Section 363 of the Bankruptcy Code allows a debtor to use, sell or lease property of its bankruptcy estate outside the ordinary course of business. The 363 sale process can be a streamlined one and typically lasts a couple of months. There is also some sanctioned cherry-picking that often occurs. The Bankruptcy Code allows a debtor to assume and assign most types of contracts and leases to a purchaser, i.e., you can acquire the favorable contracts and/or leases (as long as monetary defaults are cured and the buyer can provide adequate assurance of future performance), and leave behind the undesirable assets.

A benefit of participating in the process early is that a potential buyer can act as a "stalking horse bidder," which is an interested purchaser selected by the debtor as the opening bidder in the sale process. A stalking horse is used to draw other bidders into the sale and typically enters into a full asset purchase agreement with the debtor conditioned on other parties having a chance to submit "higher and better" offers. *Drop the gavel folks—we are having an auction!*

Why Serve as a Stalking Horse Bidder?

Wondering what's in it for you? A purchaser might be incentivized to volunteer to serve as a stalking horse for several reasons. First, the stalking horse will often have an exclusive opportunity to negotiate the terms and conditions of an asset purchase agreement with little to no initial competition. Second, the stalking horse bidder is often offered financial incentives if it is ultimately out-bid for the assets, including reimbursement of its reasonable expenses and a "break-up fee" often in the range of 3% of the bid. Therefore, entering the process early can help you negotiate the most favorable terms from the debtor and its advisors.

Following an auction and the debtor's selection of the winning bidder (generally in consultation with its stakeholders), the court conducts a sale hearing and says "yea" or "nay" to the sale. If approved, the bankruptcy court will enter an order authorizing the sale and transfer of the debtor's assets "free and clear" of all liens, claims, encumbrances and other interests, and potentially free of successor liability claims as well. *I've heard enough of that legal stuff, now give me some real world examples.*

Retail 363 Sales That Paid Off

Buyers of assets out of bankruptcy can come in many different shapes and sizes. Take Sports Authority, for example. Although it was unable to find a buyer willing to take over its massive retail operations, one of its principal competitors, Dick's Sporting Goods, scooped up certain intellectual property and 30 leasehold interests. Dick's strategically acquired royalty-generating assets, including patents relating to sports equipment, trademarks relating to the Sports Authority brand and certain private label products. Dick's also gained valuable customer information and control of Sports Authority's e-commerce site.

Similar sales involving competitors that were able to selectively acquire assets out of bankruptcy include: (1) Gordmans Stores - Stage Stores acquired certain intellectual property, leasehold interests and a distribution center; and (2) Gander Mountain - Camping World Holdings acquired a wide range of assets, including leasehold interests, intellectual property rights, operating systems and platforms, and an e-commerce business.

It is not only a debtor's competitors that have gotten in on the 363 sale action. In the Aeropostale bankruptcy proceeding, two landlords (Simon Property Group, Inc. and General Growth Properties Inc.) joined a successful bidding group that also included liquidators to save the fledgling brand by acquiring leasehold interests, inventory and certain intellectual property. Among other benefits of the acquisition, the landlords were able to strategically maintain occupancy in a number of their malls.

As you can see, opportunities abound when retailers enter Chapter 11. *Starting to hear the sound of holiday bells? They could be heralding a great opportunity to build your business.*

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