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What Is a Stalking Horse Bidder in a Section 363 Sale and Why Might I Want to Be One?

Serving as the stalking horse bidder in a Section 363 sale[1] can provide a buyer with financial and legal protections, as well as better position the buyer to ultimately acquire the debtor's assets.

General Overview

The stalking horse bidder is the bidder who sets the floor for other bidders to bid against. By establishing a baseline bid, the stalking horse bidder protects the debtor from a situation where it might only receive unreasonably low bids for its assets. In return for agreeing to serve as the stalking horse bidder, the bidder gets certain protections, which are memorialized in the asset purchase agreement between the bidder and the debtor, and approved by the bid procedures order. These protections include a break-up fee and reimbursement of reasonable expenses. The break-up fee is paid to the stalking horse bidder in the event that it is not the successful bidder and serves to compensate the bidder for the time spent negotiating the transaction. Similarly, reimbursement of reasonable expenses includes fees and expenses incurred in connection with legal and financial advice, due diligence, and other expenses incurred in connection with the transaction.

Key Issues

- **Credit Bid.** The stalking horse bidder needs to consider how it will be paid the bid protections if a secured creditor submits a credit bid. Often where a secured creditor credit bids, there is little to no money left in the estate to pay other creditors. To address this problem, the stalking horse bidder should negotiate a carve out with the secured creditor to pay the bid protections in the event of a successful credit bid by the secured creditor.
- **Timely Payment.** Even where the successful bidder is paying cash for the assets, the stalking horse bidder needs to ensure timely payment of the bid protections. Otherwise, the stalking horse bidder runs the risk that the estate will lack the funds to pay the bid protections to the stalking horse bidder. The best practice is to require the bid protections be paid to the stalking horse bidder at the time of the closing of the sale from the proceeds of the competing transaction.
- **Superpriority Administrative Expense Claim.** The stalking horse bidder needs to ensure that the debtor's obligation to pay the bidder the bid protections constitutes a superpriority administrative expense claim in favor of the bidder with priority over all other claims or interest, including pre-

[1] *See* What Is a Section 363 Bankruptcy Sale and How Does the Process Work? tp_creditors-rights-toolkit_what-is-a-section-363-bankruptcy-sale.pdf (troutman.com)

petition and post-petition amounts owing to the debtor’s pre-petition and post-petition senior secured lenders. Without this language, the stalking horse bidder runs the risk of its claim for the bid protections being treated as an unsecured claim, in which case the bidder may only get pennies on the dollar for its claim at best.

- **Auction.** Having earned the right to the break-up fee and repayment of expenses as the stalking horse bidder, the bidder needs to make sure that it is able to use those rights to its advantage at the auction. To accomplish this, the bidding procedures should be clear that in the event of an auction, the stalking horse bidder shall receive a credit in an amount equal to the bid protections and that the amount of the bid protections will be netted out of the bidder’s purchase price. It is very important that bid procedures clarify that the credit applies to all subsequent bids and not just the first overbid. Additionally, at the auction, the stalking horse bidder should be specific about the next effect of the bid protections on its bid. Instead of simply saying that the stalking horse bids $Z dollars, the stalking horse bidder should say that it is bidding $X in cash, plus the bid protections in the amount of $Y, for a total purchase price of $Z.
- **Termination of APA.** The asset purchase agreement should be clear that all provisions regarding the bid protections survive termination of the APA in the event that the stalking horse bidder is not the successful bidder for the assets. Moreover, the bid procedures order should specifically approve those provisions of the APA dealing with the bid protections as further protection for the stalking horse bidder.

Takeaway

It is important for a stalking horse bidder to work with experienced bankruptcy counsel to understand the pitfalls that can affect its bid protections and to ensure that its hard-earned bid protections will be paid should it not be selected as the successful bidder.