Southeastern Bankruptcy Law Institute

38th Annual Seminar on Bankruptcy Law and Rules
March 22 – 24, 2012

The Retailer's Last Gasp:
"Going Out of Business" Sales in Bankruptcy

David M. Neff[*]
David J. Gold[†]
Perkins Coie LLP
131 S. Dearborn St.
Suite 1700
Chicago, IL 60603
(312) 324-8689 (phone)
(312) 324-9689 (fax)
dneff@perkinscoie.com
dgold@perkinscoie.com

[*] Partner, Perkins Coie LLP

[†] Associate, Perkins Coie LLP.

I. Introduction

When retail debtors file for bankruptcy, their duty to maximize the value of their estates regularly leads them to seek the bankruptcy court's approval to liquidate their assets and hold a going out of business ("GOB") sale. A GOB sale is a liquidation sale wherein a retail debtor sells all of the merchandise in one or all of its stores to the public pursuant to Section 363 of the Bankruptcy Code. The sales are typically advertised with such terms as "going out of business," "store closing" and "liquidation." The typical sale generally lasts between one and 90 days, depending on the number of stores and complexity of the debtor's business operations, although courts will generally allow debtors additional time if necessary. While a debtor can itself conduct a GOB sale, the modern practice, especially for larger businesses, is to employ a court-sanctioned liquidating agent that specializes in such sales. Similar to a Section 363 auction of a debtor's assets, debtors seeking to conduct a GOB sale typically evaluate competitive bids from potential liquidators and submit a stalking horse liquidating agent bid for the court to evaluate with other bids through an auction process.

A debtor will typically file a motion seeking approval for the terms of the agency agreement with its stalking horse liquidating agent along with the debtor's proposed sale terms. Debtors interested in holding GOB sales are generally seeking to liquidate a substantial amount of their inventory, which may have limited shelf life and be declining in value. Accordingly, debtors often file motions for authority to conduct GOB sales within days or weeks of filing their bankruptcy petitions. Because courts will generally authorize such sales on short notice, creditors should be prepared to work with retail debtors early on in a bankruptcy case to ensure a sale process that protects their interests.[1]

[1] *See, e.g., Guiliano v. Harko, Inc. (In re NWL Holdings, Inc.)*, No. 08–12847, 2011 WL 767777, at *1 (Bankr. D. Del. Feb. 24, 2011) ("Within a month of filing, the Court heard and granted the Debtors'

GOB sales have the potential to attract more attention from consumers than regular sales and can be a debtor's best option to maximize the value of its estate. Such sales are often in conflict with the landlord's desire to protect its other tenants, the lender's desire to maintain the value of its collateral, the interests of neighboring and/or competing businesses, and the state's interest in preventing fraud on customers and unfair competition. Landlords have historically attempted to exercise control over the GOB sale process by drafting leases that limit a tenant's ability to conduct a GOB sale, or prevent it altogether. For instance, retail tenant leases typically contain provisions restricting the tenant's ability to freely advertise sales. These restrictions are often specific as to the number, size and location of signs, the language employed advertising the sale and the duration of the sale. Reasonable advertising restrictions in retail tenant leases can prove useful as guidelines for a GOB sale upon a tenant's bankruptcy filing. However, overly restrictive lease terms may cause the tenant upon filing bankruptcy to seek court approval to bypass all of the lease's advertising restrictions, and many debtors are successful in obtaining court approval to do so.

Local and state governments have also enacted comprehensive regulations for the conduct of these sales. These regulations limit such things as the size of outdoor signage, the duration of the sale as well as what merchandise can be sold as part of a store's GOB sale. The majority of bankruptcy courts have found that such restrictions are unenforceable as in conflict with a debtor's obligation to maximize the value of its estate. Accordingly, troubled retail companies may find the bankruptcy sale process smoother and less burdensome than a

---

motion to conduct 'Going Out of Business' sales."); *In re Storehouse*, Inc., No. 06-11144 (Bankr. E.D. Va. Oct. 5, 2010) (Dkt. No. 54) (second-day motion for authority to conduct GOB sale approved 16 days later); *In re BH S & B Holdings LLC*, No. 08–14604 (Bankr. S.D.N.Y. Nov. 24, 2008) (Dkt. No. 80) (second-day motion for authority to conduct GOB sale granted four days later); *In re Nat'l Book Warehouse, Inc*., No. 06-02227 (Bankr. M.D. Tenn. June 20, 2006) (Dkt. No. 161) (motion granted 18 days later).

liquidation sale outside of bankruptcy. A debtor's interest in maximizing the value of its estate means that courts are generally receptive to its GOB sale proposals. However courts will balance the interests of landlords, creditors, competitors and the public and impose reasonable restrictions on GOB sales, such as requiring compliance with public health and safety and consumer protection laws.

II. The Bankruptcy Code and restrictions on GOB sales

Section 363 of the Bankruptcy Code governs GOB sales by companies in bankruptcy. 11 U.S.C. § 363. Section 363(b)(1) states that the "trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." One of the fundamental policies in bankruptcy is that the trustee or debtor-in-possession should maximize the value of estate assets. Section 363(b) fosters that policy by allowing the sale of all, or substantially all, of the estate's assets where the debtor can show a sound business justification for doing so. *See, e.g., The Official Committee of Unsecured Creditors of LTV Aerospace & Defense Co. v. The LTV Corp (In re Chateaugay Corp.)*, 973 F.2d 141, 145 (2d Cir. 1992); *Stephens Indus., Inc. v. McClung*, 789 F. 2d 386, 390 (6th Cir. 1986); *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F. 2d 1303, 1311 n.10 (5th Cir. 1985).

Bankruptcy courts regularly authorize GOB sales for retail debtors, holding that such relief is consistent with maximizing the value of the debtor's estate. *See, e.g.*, *In re Borders Group, Inc.*, No. 11–10614, 2011 WL 3022401 (Bankr. S.D.N.Y. July 21, 2011); *In re The Great Atlantic & Pacific Tea Co.*, No. 10-24549 (Bankr. S.D.N.Y. Mar. 10, 2011) (Dkt. No. 1004); *In re Blockbuster Inc.*, No. 10-14997 (Bankr. S.D.N.Y. Jan. 20, 2011) (Dkt. No. 864); *In re Penn Traffic Co.*, No. 09-14078 (Bankr. D. Del. Jan. 25, 2010) (Dkt. No. 462); *In re Pumpkin Patch LLC*, No. 09-12200 (Bankr. D. Del. Jul 24, 2009) (Dkt. No. 100). Thus, bankruptcy courts will

not enforce lease clauses prohibiting GOB sales. *See, e.g.*, *In re Ames Dept. Stores, Inc.*, 136 B.R. 357, 359 (Bankr. S.D.N.Y. 1992) (holding that an anti-GOB sales clause in a lease was unenforceable); *In re Tobago Bay Trading Co*., 112 B.R. 463, 467 (Bankr. N.D. Ga. 1990) (same); *In re Lisbon Shops, Inc.*, 24 B.R. 693, 695 (Bankr. E.D. Mo. 1982) (same).

The same is generally true for state and local laws applicable to GOB sales, which were usually passed to combat perceived unscrupulous business practices in GOB sales, such as selling merchandise unrelated to the merchant's pre-sale business. This is because the Bankruptcy Code preempts state and local laws that conflict with the Code's underlying policies. *See, e.g.*, *Aloe v. Shenango Inc. (In re Shenango Group, Inc.)*, 186 B.R. 623, 628 (Bankr. W.D. Pa. 1995), *aff'd*, 112 F.3d 633 (2d Cir. 1997) ("Trustees and debtors-in-possession have unique fiduciary and legal obligations pursuant to the bankruptcy code. WPCL, a state statute, cannot place burdens on them where the result would contradict the priorities established by the federal bankruptcy code."); *Baker & Drake, Inc. v. Pub. Serv. Comm'n of Nev. (In re Baker & Drake, Inc.)*, 35 F.3d 1348, 1353 (9th Cir. 1994) ("federal bankruptcy preemption is more likely . . . where a state statute is concerned with economic regulation rather than with protecting the public health and safety."); *Missouri v. U.S. Bankruptcy Court (In re State of Mo.)*, 647 F.2d 768, 776 (8th Cir. 1981) ("Missouri's laws, by governing the operation and liquidation of grain warehouses, directly conflict with the control of the property by the bankruptcy court and, therefore, do not fall within the section 362(b)(4) exception."); *In re The Great Atlantic & Pacific Tea Co.*, No. 10-24549 (Bankr. S.D.N.Y. Mar. 10, 2011) (Dkt. No. 1004) ("The Debtors shall be entitled to use sign walkers, hang signs, and/or interior or exterior banners advertising the Store Closing Sales . . . without compliance with the Liquidation Sale Laws; provided, however, that the use of banners and sign walkers is done in a safe and responsible manner."); *In*

re Borders Group, Inc., 2011 WL 3022401; *In re Bruno's Supermarkets, LLC*, No. 09-00634 (Bankr. N.D. Ala. Apr. 29, 2009) (Dkt. No. 616) ("state and local licensing requirements, time limits or other restrictions on GOB Sales would undermine the fundamental purpose of section 363(b) . . . by placing constraints on Debtor's ability to marshal and maximize the value of the Assets"); *Walker v. Maury County (In re Scott Housing Sys. Inc.)*, 91 B.R. 190, 196-97 (Bankr. S.D. Ga. 1988) (holding that automatic stay is broad and preempts state law except for those laws designed to protect public health and safety).

Although the majority of courts have held that lease and statutory restrictions on GOB sales cannot restrict a debtor's ability to conduct a GOB sale, laws relating to public health and safety and consumer protection still apply. *See, e.g. In re Blockbuster Inc*., No. 10-14997 (Bankr. S.D.N.Y. Jan. 20, 2011) (Dkt. No. 864) ("Subject to applicable state and local public health and safety laws . . . and any state or local laws, regulations, or police powers of general applicability, including, but not limited to, criminal, traffic, tax, labor, employment, environmental, privacy, and consumer protection laws, including consumer laws regulating deceptive practices and false advertising (collectively, the 'General Laws'), but excluding licensing and other requirements governing the conduct of store closing, liquidation, or other inventory clearance sales, including (but not limited to) federal, state, and local laws, statutes, rules, regulations, and ordinances related to store closing and liquidation sales, establishing licensing, permitting, or bonding requirements, waiting periods, time limits, bulk sale restrictions, augmentation limitations that would otherwise apply to the Store Closing Sales and Bulk Inventory Sales, or restrictions on safe, professional, and non-deceptive, customary advertising, such as signs, banners, and posting of signage solely in connection with Store Closing Sales . . . the Debtors are authorized to take such actions as necessary and appropriate to

conduct the Store Closing Sales*"); In re Penn Traffic Co*., No. 09-14078 (Bankr. D. Del. Jan. 25, 2010) (Dkt. No. 462) (same); *In re Pumpkin Patch LLC*, No. 09-12200 (Bankr. D. Del. Jul 24, 2009) (Dkt. No. 100) (same).

Aside from Section 363, one of the other potentially relevant federal statutes relating to GOB sales is 28 U.S.C. § 959(b). That section states that a trustee or debtor-in-possession "shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof." Read literally, that statute appears to require that local and state laws regulating GOB sales govern the GOB sale process. However, courts have generally held that this statute is only relevant to debtors continuing to operate businesses and not to liquidating entities. *See, e.g.*, *S.E.C. v. Wealth Mgmt. LLC*, 628 F.3d 323, 334 (7th Cir. 2010) ("Modern courts have followed this reasoning and likewise concluded that § 959(b) does not apply to liquidations."); *Ala. Surface Min. Comm'n v. N.P. Min. Co. (In re N.P. Min. Co.)*, 963 F.2d 1449 (11th Cir. 1992) (same); *Mo. Dept. of Natural Res. v. Valley Steel Prods. Co. (In re Valley Steel Prods. Co.)*, 157 B.R. 442, 447 (Bankr. E.D. Mo. 1993) (same); *In re I.D. Craig Serv. Corp*., 138 B.R. 490, 500 (Bankr. W.D. Pa. 1992) ("The majority view is that § 959 does not apply in chapter 7 cases where the trustee does not operate or manage a business but liquidates assets. . . . It is arguable that liquidation entails management but the cases that espouse this view are in the minority and frequently deal with public welfare."); *but see Lancaster v. Tenn. (In re Wall Tube & Metal Prods. Co.)*, 831 F.2d 118, 123 (6th Cir. 1987) ("Nor are we convinced that Section 959(b) is inapplicable to liquidating trustees, as respondents argue. . . . Congress' intentions that the trustee's efforts 'to marshal and distribute the assets of the estate' give way to the governmental

interest in public health and safety."); *In re Crawford Furniture Mfg. Corp*., --- B.R. ----, Nos. 11–12945 B, 11–12946, 2011 WL 6325859, at *2 (Bankr. W.D.N.Y. Dec. 5, 2011) ("Crawford Retail must still comply with state and local laws and regulations. The present motion sought a waiver of most of these restrictions. Because such a broad waiver would have violated the mandate of 28 U.S.C. § 959(b), this court denied the motion in its original form.").

III. Legislative restrictions on GOB sales

A. Signage and advertising restrictions

One of the large areas of contention in a retail debtor's GOB sale plan is how the debtor advertises its sale. *See, e.g.*, *In re Crown Books Corp*., 269 B.R. 12, 15 (Bankr. D. Del. 2001) ("Objections were filed by numerous landlords, including NHDB, which raised significant issues regarding the conduct of the GOB sales."). From the number, size and location of signs to the language employed advertising the sale, parties generally contest how GOB sales can be presented to the public. Inaccurate advertising can lead to consumer confusion and/or deception and inelegant signage can worsen the public image of a shopping district and negatively affect nearby businesses. While disputes still arise relating to a debtor's GOB sale advertising plans, many state and local governments have passed comprehensive GOB sale laws regulating GOB advertising in response to such disputes that reflect a balance of the competing interests of all parties. Of the various types of GOB sale restrictions, signage and advertising restrictions (other than those relating to deceptive business practices) are generally negotiated and subject to modification by the bankruptcy court. While courts and parties often look to the debtor's lease, local and state regulations on GOB sale advertising for guidance as to reasonable restrictions on the process, courts may also allow debtors to avoid compliance with any restrictions on GOB sale advertising other than laws relating to consumer protection. *See, e.g.*, *In re FFW OPCO,*

Ltd., No. 10–33761, 2010 WL 5209251, at *5 (Bankr. N.D. Tex. Jun. 9, 2010) ("The Sale shall be conducted by FFW and PFP without the necessity of compliance with any federal, state or local statute or ordinance (other than Safety Laws), lease provision, or licensing requirement affecting store closing, going out of business, bankruptcy liquidation or auction sales, or affecting advertising, including signs, banners, and posting of signage"); *In re Nat'l Book Warehouse, Inc*., No. 06-02227 (Bankr. M.D. Tenn. June 2, 2006) (Docket No. 79-3) ("The Debtors shall not place any signs nor distribute handbills, leaflets or other written materials to customers outside of any Store's premises, except as permitted by the lease or otherwise agreed to by the applicable landlord, but may solicit customers in the Stores themselves. The Debtors shall not use flashing lights or any type of amplified sound to advertise the Store Closing Sales or solicit customers, except as permitted by the lease or agreed to by the landlord.").

An example of a GOB signage regulation from the City of Monterey, California is as follows:

> (c) One time only "Going Out of Business" sign per street frontage (frontage shall mean building facades facing a street, facing a parking lot and/or facing a pedestrian mall) up to a maximum of two (2) signs, which shall require a permit issued by the Department of Plans and Public Works and signed by the business owner or manager. The business is required to secure a "Going Out of Business Sale" license issued by the Finance Director under Section 15-3(a) and (b) of the Monterey City Code prior to this sign permit approval. The maximum size of the sign shall not exceed twenty (20) square feet in area. These signs shall be secured flat against the building or on a window and shall not be placed on or in the public right-of-way, be attached to public property, be attached to the roof, be internally illuminated, be electric or be neon.
>
> (d) Temporary window sign(s) may be displayed for a period not to exceed thirty (30) days and shall require a permit issued by the Department of Plans and Public Works and signed by the business owner or manager. These temporary signs shall conform with the following standards:
>
> 1. The signs shall not be electric or neon.
>
> 2. The signs, except for paint decals or vinyl letters, shall be attached

inside the window.

3. The colors shall not be luminous or contain phosphorescent substance.

4. The signs are allowed on half (1/2) the windows on a frontage up to a maximum of two (2) windows. The signs in these windows shall not cover more than thirty percent (30%) of the window. All other windows on the frontage shall be free of signs unless the sign has been already approved as a permanent business identification sign by ARC permit.

5. No more than one (1) such permit shall be issued at one time to an individual business.

6. The total number of days allowed for display of any temporary signs exceeding 10% window coverage shall not exceed sixty (60) days in any one calendar year.

7. A window shall mean an opening in a wall or door, functioning to admit light usually framed and spanned with glass.

8. Frontage shall mean building facades facing a street, facing a parking lot and/or facing a pedestrian mall.

Monterey Mun. Code § 31-14.

B. Restrictions on duration of GOB sales

Another issue of dispute in GOB sales is the duration within which the sale can take place. A retailer wants maximum flexibility to conduct a sale for as long as is necessary to liquidate its goods. Landlords, lenders and surrounding businesses, however, can suffer from an extended GOB sale through the diminishment of a store's public image. This is especially true in higher-end shopping districts. Despite lease provisions and laws to the contrary, bankruptcy courts have generally allowed extended GOB sales to the extent necessary to fully liquidate a debtor's inventory. *See, e.g.*, *In re Crawford Furniture Mfg. Corp*., 2011 WL 6325859, at *5 ("the court found that those customers would derive comparatively minimal benefit from a strict limitation of the length of the proposed sale. Accordingly, we allowed a waiver of the provisions of General Business Law § 590(a), that would have limited the sale to a duration of no more than

sixty days"); *In re Borders Group, Inc.*, 2011 WL 3022401, at *9 (holding that the debtor could hold a four-month sale with the option of requesting court approval for further time); *In re Nat'l Book Warehouse, Inc*., No. 06-02227 (Bankr. M.D. Tenn. June 20, 2006) (Docket No. 161) (order authorizing GOB sale set no requirements for length of sale); Paul Traub & Susan F. Balaschak, *Going Out of Business Sales: Balancing the Interests of Landlords, Creditors, Regulatory Agencies and the Public in Chapter 11 Retail Cases*, 9 J. Bankr. L. & Prac. 91, 97 (1999) ("Chapter 11 retail debtors routinely request that they or their liquidators be permitted to conduct GOB Sales well beyond the time period permitted for such sales by state and local laws. Such request[s] are routinely granted by most bankruptcy courts.").

An example of a law restricting GOB sale duration is as follows:

> A license to conduct a sale issued pursuant to this article shall be good for no more than a period of thirty consecutive calendar days and may be renewed for one consecutive period not exceeding thirty consecutive calendar days upon the affidavit of the applicant that the goods, wares and merchandise listed in the inventory have not been disposed of and that no new goods, wares and merchandise have been or will be added to the inventory previously filed pursuant to this article by purchase, acquisition, on consignment or otherwise.

N.Y. Gen. Bus. Law § 590(a).

C. Restrictions on augmentation of a store's inventory

Another heavily disputed issue in GOB sales is whether a store conducting the sale can augment its inventory with that of its sister stores that are not conducting a GOB sale, with new inventory produced during the GOB sale by the store's suppliers or with inventory from the debtor's liquidating agent. If given free reign to conduct a GOB sale, a multi-store business may find a competitive advantage in pumping inventory into those stores holding GOB sales to boost overall sales at the expense of its competitors. Additionally liquidation companies often want to take advantage of the heavy customer traffic generated by GOB sales by selling their own

inventory through a retailer's GOB sale. These actions by liquidators have attracted scrutiny from state legislatures keen on protecting consumers from dishonest advertising and sales practices. In particular, the states have been concerned about the potential for fraud on the consumer, who may wrongfully believe that the inventory being sold at the GOB sale is the retailer's prior inventory.

Bankruptcy courts have taken a mixed approach to augmentation issues. Some courts have refused to permit augmentation, some have allowed multi-store businesses to transfer inventory to the stores holding the GOB sale, and other courts have even allowed the GOB sale liquidating agent to sell its own merchandise through the debtor's sale. *See, e.g.*, *In re Filene's Basement, LLC*, No. 11-13511 (Bankr. D. Del. Nov. 16, 2011) (Dkt. 189) ("the Debtors and/or the [liquidating] Agent (as the case may be) are authorized and empowered to transfer Merchandise among the Debtors' distribution centers and/or the Stores. . . . Agent is hereby authorized to supplement the Merchandise in the Stores with goods of like kind and quality as are customarily sold in the Stores, which merchandise shall not exceed $15 million at Agent's cost as an Expense of the sales); *In re Lauriat's Inc*., 219 B.R. 648, 649 (Bankr. D. Mass. 1998) ("[Debtors] urge that I exempt them from certain provisions of state law regarding closing-out sales. Debtors urge that only by obtaining such an exemption can they maximize recovery for the estate from the assets of the stores to be closed. . . . Here the federal statute restricts the powers which may be exercised by federal court officers; it does not expand them beyond what is permitted by state law."); *In re White Crane Trading Co.*, 170 B.R. 694, 702-03 (Bankr. E.D. Cal. 1994) (holding that the debtor's GOB sale plan ran afoul of California law prohibiting a liquidating entity from obtaining new inventory specifically for a GOB sale); *In re Willis Furniture Co., Inc*., 148 B.R. 691 (Bankr. D. Mass. 1992) (allowing the augmentation of the

debtor's GOB sale merchandise with the liquidator's merchandise so long as the debtor did not advertise the sale as a "Bankruptcy Chapter 11 Sale"). The more recent trend among bankruptcy courts allows augmentation if it will result in a higher return for the estate and if the GOB sale is clearly advertised as including goods provided by the liquidating agent.

An example of a law restricting augmentation of a retailer GOB sale inventory is as follows:

> No person, firm, limited liability company, corporation, or association, in contemplation of conducting any sale regulated by this chapter, shall order any goods for the purpose of selling and disposing of the goods at such sale. However, the prohibition of this section shall not apply to the purchase of goods damaged or altered by fire, smoke, water, vandalism or other similar means, or goods purchased from a seller who has discontinued his business. In the event of any unusual purchase or addition to the stock of goods within sixty (60) days prior to the filing of the application for license to conduct such sale, the burden in all civil or criminal litigation shall fall upon the purchaser to show that such purchases and additions to the stock were not made in contemplation of such sale or for the purpose of selling the goods at such sale.

Ind. Code § 25-18-1-10.

D. Permit and registration requirements

Local and state governments often require a retailer planning to hold a GOB sale to register with the applicable agency and allow that agency to inspect the sale inventory to insure that the retailer truthfully represents its sale to the public. An example of a law requiring a retailer to obtain a permit prior to advertising and holding a GOB sale is as follows:

> . . . Every county, town and city shall issue permits to retail merchants for special sales as required by § 18.2-223 upon the application of such merchant and shall inspect the advertisement and conducting of such sale to insure that it is being advertised and conducted in conformity with the required permit.
>
> All applications for special sale permits shall be accompanied by an inventory, including the kind and quantity of all goods which are to be offered for sale during the sale and only the goods specified in the inventory list may be advertised or sold during the sale period. Goods not included on the inventory of special sale goods shall not be commingled with or added to the special sale

> goods. Each county, city or town shall have the right to revoke a special sale permit upon proof that goods not appearing on the original inventory of special sale goods have been commingled with or added to the special sale goods . . .

Va. Code Ann. § 18.2-224. While these types of statutes are preempted in a bankruptcy GOB sale, bankruptcy courts will generally allow the enforcement of laws prohibiting dishonest GOB sale practices, such as misleading advertising. *See, e.g.*, *In re FFW OPCO, Ltd*., No. 10–33761, 2010 WL 5209251, at *4 (Bankr. N.D. Tex. June 9, 2010) ("no further approval, license or permits of any governmental authority shall be required; provided, however, that [the debtor and the liquidating agent] continue to be bound by and comply with the state and local public health and safety laws . . . and tax, labor, employment, environmental and consumer protection laws, including consumer laws regulating deceptive practices and false advertising"); *In re Int'l Oriental Rug Ctr., Inc*., 165 B.R. 436, 438 (Bankr. N.D. Ill. 1994) (noting that if the debtor acted pursuant to a court-authorized GOB sale, the local village ordinance requiring a license to hold a GOB sale would "not apply").

IV. Conducting a GOB sale

GOB sales are typically conducted through a liquidating agent nominated by the debtor and approved by the bankruptcy court, alongside a comprehensive agency agreement governing the agent's compensation, the sale process and the methodology for inventorying the goods. There are many companies specializing in GOB liquidation sales, including liquidators sub-specializing in particular industries. Selection of a liquidator with experience marketing and selling the debtor's particular type of merchandise is important to ensuring a successful sale and the maximization of the value of the estate's assets. Similar to other Section 363 bankruptcy sales, debtors typically obtain a stalking horse agent and establish bid procedures for determination of the liquidation agent. These bid procedures generally also establish guidelines

for objecting to the debtor's proposed GOB sale terms. The court, upon motion, will hold an auction process to determine the liquidating agency and approve procedures for conducting the sale.

V. "Going dark" and continuous use lease provisions

Many commercial leases include provisions providing that if the tenant does not continuously operate for a specific period of time after execution of the lease, known as a "dark" period, the lease is in default and the landlord can terminate the lease and evict the tenant. These provisions are known as "going dark" clauses or continuous operations restrictions. Landlords include these provisions to ensure that they are not stuck with vacant, but otherwise rentable, space upon the failure of one of their tenants' businesses.

On the other hand, an assignee of a retail lease in a bankruptcy will necessarily require time to renovate the unit and prepare it for the particular operational needs of the assignee's business. Lease clauses that prohibit dark periods or prohibit reasonable dark periods prevent the tenant from assigning the lease after the unit has gone dark and/or fail to provide sufficient time for the assignee to take over the unit and conform it to its needs.

In situations where a tenant's unit has gone dark for an extended period of time, the result can be devastating for the landlord and surrounding businesses. Although such lease provisions serve a valuable economic purpose for landlords, they are generally unenforceable under the Bankruptcy Code as anti-assignment clauses that run afoul of Section 365(f). That Section provides that "notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease" if the trustee assumes the lease or provides adequate assurance of future performance of the assignee of the lease. 11 U.S.C.

§ 365(f); *see, e.g.*, *In re New York Chocolate & Confections Co*., No. 10–30963, 2010 WL 4739714, *10 (Bankr. N.D.N.Y. July 15, 2010) ("any 'going dark', continuous operating restrictions, minimum purchase requirements and/or other related restrictions in any Assumed Contract are unenforceable anti-assignment clauses under sections 365(f)(1) and (3) of the Bankruptcy Code."); *In re Goody's, LLC*, No. 09–10124, 2009 WL 7812260, *6 (Bankr. D. Del. 2009) (the Sale shall be conducted by the Debtors . . . notwithstanding any restrictive provision of any lease . . . including (without limitation) . . . 'go-dark' provisions"); *In re Ground Round, Inc*., No. 04–11235, 2004 WL 1732207, *7 (Bankr. D. Mass. July 12, 2004) ("any provision of the . . . lease in the nature of a restriction on the interruption of the operations . . . including, without limitation, any continuous operations provision or 'going-dark' clause, or similar clause prohibiting the cessation of operations at the leased premises is unenforceable against the assignee thereof"). "It is fundamental that a debtor may assign its leases notwithstanding contractual anti-assignment provisions. . . . This rule derives from the strong policy favoring assignments so as to maximize value of the estate." *In re Bradlees Stores, Inc*., Nos. 00–16033, 00–16035, 00–16036, 2001 WL 34809984, at *7 (Bankr. S.D.N.Y. Mar. 28, 2001).

Landlords may be able to enforce going dark lease provisions in a bankruptcy where the provisions allow for reasonable dark periods, but that restrict open-ended dark periods. *See, e.g.*, *The Shaw Group, Inc. v. Northrup Grumman Technical Servs., Inc. (In re The IT Group, Inc.)*, 302 B.R. 483, 488 (D. De. 2003) (holding that bankruptcy courts have discretion in determining whether lease provisions that do not explicitly prohibit assignment qualify as de facto anti-assignment clauses); *In re Service Merchandise Co*., 297 B.R. 675, 693-94 (Bankr. M.D. Tenn. 2002) (holding that a "going dark" provision allowing the landlord to evict the tenant after a nine-month dark period was enforceable where the nine-month period had not run and time

remained for the assignee to take over the lease and renovate the unit); *In re Ames Dept. Stores, Inc*., 287 B.R. 112, 126 n.34 (Bankr. S.D.N.Y. 2002) ("Other aspects of designation rights transactions sometimes leading to controversy include provisions . . . invalidating 'going dark' or use provisions as violative of section 365(f). Whether provisions of that character are appropriate, appropriate in concept but excessive in time or scope, or inappropriate will depend on the facts of the case"). However, a court applying a literal reading of Section 365(f), which states that a lease provision cannot "restrict" or "condition" the assignment of a lease, may still find flexible dark period provisions unenforceable.

Landlords should ensure that the going dark provisions in their leases are flexible and allow for short dark periods, or dark periods for assignees of the lease, so that there is a greater chance that a bankruptcy court will uphold those provisions. Landlords may also want to consider charging a fee for dark periods. Should the debtor-tenant decide to assume or assign its lease, the debtor or its assignee would be required to cure all payment defaults, including failure to pay a going dark fee. *See* 11 U.S.C. §§ 365(b), (f); *see also* Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 Am. Bankr. L.J. 663, 747 (2009) ("If the debtor violates a going-dark clause in a nonresidential real property lease, then the bankruptcy estate may nevertheless assume the lease if the trustee operated the premises in accordance with the lease from the time of assumption and compensates the landlord for pecuniary losses cause by the default.").

The unenforceability of going dark provisions in bankruptcy could be magnified in situations involving a debtor-tenant in a multi-tenant mall or shopping center. In such situations, the landlord and other tenants could conceivably be forced to endure prolonged periods of time with reduced customer traffic, which would be magnified if the bankrupt retailer was an anchor

tenant. To address that situation, Section 365(b)(3)(C) of the Bankruptcy Code states that the limitations on anti-assignment clauses in Section 365(f) do not apply to shopping center leases and that assignment of such leases are subject to "all of the provisions" of the lease, including restrictions on "radius, location, use, or exclusivity" and "any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center." Accordingly, going dark provisions that prevent the assignment of a lease are enforceable against shopping center tenants in bankruptcy. *See, e.g.*, *In re Joshua Slocum Ltd*., 922 F.2d 1081 (3d Cir. 1990) ("The Bankruptcy Code imposes heightened restrictions on the assumption and assignment of leases for shopping centers. See 11 U.S.C. § 365(b)(3). . . . Congress recognized that unlike the usual situation where a lease assignment affects only the lessor, an assignment of a shopping center lease to an outside party can have a significant detrimental impact on others, in particular, the center's other tenants."); *In re Antwerp Diamond, Inc*., 138 B.R. 865, 867 (Bankr. N.D. Ohio 1992) ("To the extent that the leases on those leased premises contain anti-G.O.B. sale clauses, such intended activity by the Debtors' bidder would be in derogation of the rights of those other tenants similarly affected by those leases and clearly would be violative of § 365(b)(3)(C)").

VI. Example of a recent GOB sale - Circuit City

The going out of business sale in the Circuit City bankruptcy case is an example of the current trend in GOB bankruptcy sales – one that generally favors the debtor. In that case, the debtor moved on an expedited basis for authority to conduct a GOB sale through the use of a liquidating agent. On only one week of notice, the court approved an expansive GOB sale order that allowed the debtor and its designated liquidating agent to conduct a GOB sale for 567 retail stores located throughout the country. The sale order: (1) permitted the debtor to forgo

compliance with all GOB sale laws[2]; (2) required the debtor to comply with health, safety and false advertising laws; (3) limited the scope of the property subject to the sale to merchandise owned by the debtor; and (4) placed a small number of restrictions on the permitted signage and advertising allowed.[3] Although no attorneys general or local governments objected to the terms in the debtor's motion for authority to conduct the GOB sale other than to raise tax issues, they had little time to object. Their lack of objection to the circumvention of state and local restrictions on GOB sales may be an acknowledgement of their limited ability to superimpose such restrictions on the bankruptcy GOB sale process. Additionally, several of the debtor's landlords unsuccessfully objected to the debtor's GOB sale motion, arguing insufficient notice and requesting revisions to the debtor's proposed GOB sale order in order to conform it to the

[2] *In re Circuit City Stores, Inc.*, No. 08-35653 (Bankr. E.D. Va. Jan. 16, 2009) (Dkt. No. 1634) ("The Sale at the Debtors' applicable retail store locations shall be conducted by the Debtors and the Agent without the necessity of compliance with any federal, state or local statute or ordinance, lease provision or licensing requirement affecting store closing, 'going out of business,' liquidation or auction sales, or affecting advertising, including signs, banners, posting of signage, and use of sign walkers, and including ordinances establishing licensing or permitting requirements, waiting periods, time limits or bulk sale restrictions that would otherwise apply to the Sale ('GOB Laws'), other than Safety Laws and General Laws, except as may otherwise expressly be provided for in the Sale Guidelines.").

[3] *Id.* ("Within a shopping center, Agent shall not distribute handbills, leaflets or other written materials to customers outside of any Closing Locations' premises, unless permitted by the lease or, if distribution is customary in the shopping center in which such Closing Location is located. Otherwise, Agent may solicit customers in the Closing Locations themselves. . . . All display and hanging signs used by the Agent in connection with the Sales shall be professionally produced and all hanging signs shall be hung in a professional manner. The Merchant and the Agent may advertise the Sale as a 'going out of business', 'store closing' or similar themed sale. The Merchant and the Agent shall not use neon or day-glo signs. Furthermore, with respect to enclosed mall locations, no exterior signs or signs in common areas of a mall shall be used. Nothing contained herein shall be construed to create or impose upon the Agent any additional restrictions not contained in the applicable lease agreement. In addition, the Merchant and the Agent shall be permitted to utilize exterior banners at non-enclosed mall Closing Location locations or at mall locations if the Closing Location has a separate entrance from a parking lot; provided, however, that such banners shall be located or hung so as to make clear that the Sale is being conducted only at the affected Closing Location and shall not be wider than the storefront of the Closing Location. In addition, the Merchant and the Agent shall be permitted to utilize sign walkers, A-frame, interior and exterior banners and similar signage, notwithstanding any state, county or local law or ordinance.").

GOB sales restrictions in their leases.[4] The Circuit City case is a reminder that a retail debtor has a relatively free hand to conduct a GOB sale. Rather than attempting to control the process through objecting to the sale, interested parties are likely to be better off working with the debtor to craft the GOB sale plan. If left to discretion of the bankruptcy court, the debtor may be successful in obtaining court approval for almost all of its proposed terms over its creditors' objections. *See* Karen Cordry, *Going-Out-of-Business Sales and State Law: No More Mister Nice Guy*, 21-Jun Am. Bankr. Inst. J. 8, 41 (2002) ("if liquidators and debtors are aware of the operational concerns . . ., it should be possible to structure the sales procedures to meet those concerns—and to do so before the bids are taken, rather than afterward. In the recent cases, the debtors argued that they were limited in making changes to their sale orders because the bid process had already begun and certain methods of operation were presumed to apply. . . . [T]he reality is that most courts would be reluctant to upset those arrangements. Thus, it is critical to put all parties on notice before the fact as to the likelihood that they will face objections if they continue proposing overreaching orders.").

VII. A debtor's lease designation and assignment rights

A debtor seeking to liquidate some of all of its operations may seek to assign its leases to extract value for its estate pursuant to Section 365 of chapter 11 of the Bankruptcy Code, which allows a debtor to assign, reject or assume its leases. 11 U.S.C. § 365. As discussed above, while leases typically have provisions restricting their assignment, such provisions are unenforceable upon a tenant's bankruptcy filing unless a tenant has a lease at a shopping center.

[4] For instance, one of the landlords was unsuccessful at enforcing the majority of the GOB sale restrictions in its lease, including lease provisions prohibiting: (1) extension banners or other exterior signage; (2) solicitation of customers outside of the premises; (3) sign walkers, A-Frames, sandwich boards or street signage; (4) more than one sign in any front window of the store and signs taking up more than 50% of the window space; (5) setback of signs placed in a store's front window; (6) interior banner size and location; (7) total additional in-store signage; and (8) interior or exterior balloons. *See In re Circuit City Stores, Inc.*, No. 08-35653 (Bankr. E.D. Va. Jan. 16, 2009) (Dkt. No. 1584).

In order to assign a lease, the debtor must comply with the requirements under Section 365(b)(1) for assumption of an executory contract and show that the assignee can provide adequate assurance of future performance regardless of whether defaults exist on the lease. *See* 11 U.S.C. § 365(f)(2). Accordingly, in exchange for forcing landlords to accept a new tenant that it may not want, a debtor must cure of all outstanding defaults on the lease and ensure that the landlord will receive the full benefit of its bargain in order for the court to approve a lease assignment. *See Eastern Air Lines, Inc. v. The Ins. Co. of the State of Pa. (In re Ionosphere Clubs, Inc.)*, 85 F.3d 992, 999 (2d Cir. 1996); *In re Superior Toy & Mfg. Co.*, 78 F.3d 1169, 1174 (7th Cir. 1996).

Financially burdened debtors do not always have the resources or the acumen to sell and assign their leases to provide maximum value to their estates. One solution to maximizing the value of a debtor's estate is selling the debtor's rights to assign its lease, known as its "designation rights," to a real estate company that has the experience and resources to market and sell the lease in exchange for a share of the proceeds. Cory Lipoff, *Downsizing in Retail Chapter 11 Cases* (Am. Bank. Inst. Newsletter), Mar. 2004, at 16. Landlords generally object to a debtor's ability to assign leases in bankruptcy, and sales of designation rights in particular, because they lose the ability to control tenant selection. A landlord's ability to control tenant selection is important in ensuring its profitability and a real estate company is more likely to be successful in marketing a debtor's lease than a financially strapped debtor.

The few courts that have examined whether debtors can sell their designation rights have found that the value remaining on a lease is property of a debtor's estate, and, as such, debtors can sell their designation rights pursuant to Section 363. *See, e.g.*, *In re Chrysler LLC*, 405 B.R. 84, 110 (Bankr. S.D.N.Y. 2009) ("similar procedures have been approved in this district and

elsewhere"); *In re Ames Dept. Stores, Inc.*, 287 B.R. 112, 116-17 (Bankr. S.D.N.Y. 2002) ("It is undisputed that the sale of designation rights as sought under the Motion would make a great deal of business sense for the Debtors' creditors generally, and, if permissible, would easily pass muster under all of the traditional factors that a court looks to under any motion for approval of a transaction under section 363(b) . . . the sale of designation rights is hardly novel; it has been repeatedly approved, in at least 15 instances, and in the only two reported decisions that have addressed the matter."); *In re Ernst Home Ctr., Inc*., 209 B.R. 974, 979-80 (Bankr. W.D. Wash. 1997) ("Ernst's decision to enter into the FADCO Transaction is a sound and justified business decision. The FADCO Leases represent the only source for a potential distribution to unsecured creditors in this case. Ernst's receipt of at least $12 million under the FADCO Agreement, therefore, is of significant benefit to the estate.").

VIII. Conclusion

Bankruptcy courts are generally inclined to allow retail debtors to sell their inventory in GOB sales subject to reasonable restrictions. Because retailer debtors are often in a hurry to liquidate their merchandise, interested parties should be aware that courts will often grant debtors the authority to conduct GOB sales on an expedited basis. Frequent communication between the debtor, the landlord, state attorneys general and other interested parties is important to insuring that any GOB sale process reflects the interests of all parties.