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If bankruptcy is not "clearly imminent," corporation must be valued on a going concern basis

***In re Hechinger Investment Company of Delaware,* 2005 U.S. Dist. LEXIS 14386 (D. Del., July 19, 2005).** *Judge Robinson.*

The ability of a business to meet its obligations is an essential element in determining value. In June 1999, **Hechinger Company** and its affiliates (Hechinger) filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. This followed the acquisition and subsequent combination of the assets of **Builders Square, Inc. (Builders Square)** with Hechinger by **Leonard Green & Partners, L.P. (Leonard Green)** in September 1997 ("the Transaction").

The liquidation trust asserted, inter alia, that Hechinger was insolvent at the time of the Transaction or was rendered insolvent as a result of the Transaction, and that certain of its directors knew or should have known of Hechinger's insolvency, and had breached their duty.

To determine whether Hechinger was insolvent or in the vicinity of insolvency, the trial court first noted that the definition of "insolvent" is a "financial condition such that the sum of [a corporation's] debts is greater than all of such entity's property, at a fair valuation…." The Bankruptcy Code does not, however, mandate what constitutes a "fair valuation." Nonetheless, the court ruled that in the context of determining insolvency under the Code, where bankruptcy is not "clearly imminent" on the date of the challenged conduct, assets should be valued on a going concern basis. Moreover, the court noted that because valuation is, to a great extent, a subjective exercise dependent upon the input of both facts and assumptions, the court will give deference to "prevailing marketplace values," rather than to values created with the benefit of hindsight for the purpose of litigation.

Finding that bankruptcy was not "clearly imminent" in September 1997, as it could not be disputed that Hechinger continued to operate and satisfy all of its obligations to its creditor constituency for well over a year subsequent to the Transaction, the court held that the assets of Hechinger should be valued on a going concern basis. Accordingly, the court refused to grant summary judgment on this issue and left it for trial.