

Educational Materials

Tuesday, September 29, 2015 | 9:00 AM – 10:00 AM

How to Win (or Lose) Bankruptcy Auctions

Presented by:

NCBJ

National Conference
of Bankruptcy Judges



NCBJ | National Conference
of Bankruptcy Judges

How to Win (or Lose) Bankruptcy Auctions

Moderator:

Hon. Robert A. Gordon

U.S. Bankruptcy Court for the District of Maryland
Baltimore, MD

Panelists:

Edward T. Gavin CTP

Gavin/Solmonese LLC
Wilmington, DE

Shaunna D. Jones

Willkie Farr & Gallagher LLP
New York, NY

Coral Lopez-Castro

Kozyak Tropin & Throckmorton, LLP
Coral Gables, FL



NCBJ 89th Annual Conference
September 29, 2015 - Fontainebleau - Miami Beach, FL

SECTION 363 SALES: BANKRUPTCY AUCTION ISSUES

By: **Shauna D. Jones – Willkie Farr & Gallagher LLP & Corali Lopez Castro – Kozyak Tropin & Throckmorton LLP¹**

Chapter 11 bankruptcy auctions have become more prevalent. Distressed businesses have found success auctioning their assets either outside or in conjunction with a plan process, with the assets being sold either as a going concern, or in a more piecemeal fashion. These materials focus on issues prospective sellers and purchasers should consider in the auction process, including limitations on the debtors' ability to sell their assets "free and clear" under 11 U.S.C. § 363(f). Also discussed are issues that can impact an auction's success including the sale of customer data, credit bidding, and the role creditors can and should take in the auction process. Sellers that understand where other debtors have stumbled will have a greater chance of successfully selling their assets. Bidders have also learned the hard way that process is important, in order to inoculate auctions from later challenges, and that the highest dollar bid does not always prevail. Bidders that are armed with an understanding of the potential pitfalls of a bankruptcy auction will be in a better position to make the best decision, even if that means walking away from the auction.

I. ASSUMED LIABILITIES

A. Involuntarily Assumed Liabilities – Although 11 U.S.C. § 363(f) provides for the sale of a debtor's assets free and clear of any interest in the property, asset purchasers may nevertheless find themselves responsible for certain liabilities such as future tort claims and environmental claims. In determining whether these claims can be asserted against the debtor's successor, the court's inquiry will focus on (i) when the claims arose for purposes of the discharge; and (ii) whether a discharge of those claims complies with due process requirements. Labor-related claims may also be assumed when a debtor utilizes a unionized workforce.

1. Tort Claims – Successor liability tort claims are probably the most common type of claims that can cause trouble for an asset purchaser. Courts have used different approaches to determine whether tort claims arising after an asset sale can be brought against the debtor's successor, or whether those claims were discharged in the bankruptcy case:

a. Conduct test – Courts following the conduct test require some sort of pre-petition exposure to a product or other conduct giving rise to an injury in order for a claim to arise. The claims can be discharged, even though the injury manifests after the reorganization. See Grady v. A.H. Robins Co., Inc., 839 F.2d 198, 199, 203 (4th Cir. 1998) (finding that plaintiff held a pre-petition Dalkon Shield claim against the debtor where the product was inserted pre-petition, but the injuries manifested two months post-petition).

¹ The authors would like to thank Andrew S. Mordkoff of Willkie Farr & Gallagher LLP and Mindy Y. Kubs of Kozyak Tropin & Throckmorton LLP for their important contributions to these materials.

b. Frenville accrual test – In Avellino & Bienes v. M. Frenville Co., Inc. (In re M. Frenville Co., Inc.), 744 F.3d 332, 337 (3d Cir. 1984), the Third Circuit looked to New York state law in determining that a creditor’s claim of indemnification and contribution was not subject to the automatic stay because it did not accrue until the creditor was sued post-petition. Frenville has been summarized as holding that “the existence of a valid claim depends on: (1) whether the claimant possessed a right to payment; and (2) when that right arose” as determined by reference to the relevant non-bankruptcy law. Kilbarr Vorp. v. Gen. Servs. Admin. Office of Supply & Serv. (In re Remington Rand Corp.), 836 F.2d 825, 830 (3d Cir. 1988).

The Frenville approach was rejected by many courts of appeals. See, e.g., Watson v. Parker (In re Parker), 313 F.3d 1267, 1269–70 (10th Cir. 2002); Epstein v. Off’l Comm. of Unsecured Creditors of the Estate of Piper Aircraft Corp. (In re Piper Aircraft Corp.), 58 F.3d 1573, 1576 n.2 (11th Cir. 1995); Cadleway Props., Inc. v. Andrews (In re Andrews), 239 F.3d 708, 710 n.7 (5th Cir. 2001).

The Third Circuit ultimately overruled Frenville in Jeld-Wen, Inc. v. Van Brunt (In re Grossman’s Inc.), 607 F.3d 114, 121 (3d Cir. 2010). In that case, a woman who allegedly purchased asbestos-containing products from the debtor sued the debtor’s successor nearly 10 years after confirmation of the debtor’s plan. The successor moved to reopen the bankruptcy case and sought a determination that the claim was discharged. The court overruled Frenville on the basis that its interpretation of “claim” under the Bankruptcy Code was too narrow, and placed too much emphasis on state law. The Circuit Court held that a “claim” arises “when an individual is exposed pre-petition to a product or other conduct giving rise to an injury, which underlies a ‘right to payment’ under the Bankruptcy Code.” Id. at 125. The Circuit Court further expressed that the inquiry must also include a determination of whether discharge of the claim would comply with the fundamental principles of due process. In other words, was the claimant given sufficient notice of her claim and an opportunity to protect that claim in the bankruptcy?

The Circuit Court remanded the case to the district court to determine whether the claim was discharged, suggesting the district court consider certain factors including: the circumstances of the claimant’s initial exposure to the asbestos, whether or when the claimants were aware of their vulnerability to asbestos, whether the notice of the claims bar date came to their attention, whether the claimants were known or unknown creditors, and whether the claimants had a colorable claim at the time of the bar date. Id. 127.

c. Prepetition relationship approach – Under this test, a claim arises from a debtor’s pre-petition tortious conduct where there is a pre-petition relationship between the claimant and the debtor, such as where the claimants had purchased, used, operated or been exposed to a product manufactured or

sold by the debtor. See e.g. Piper, 58 F.3d at 1577. The test articulated in Piper, which has been followed by other courts, states as follows:

an individual has a § 101(5) claim against a debtor manufacturer if (i) events occurring before confirmation create a relationship, such as contact, exposure, impact, or privity, between the claimant and the debtor's product; and (ii) the basis for liability is the debtor's prepetition conduct in designing, manufacturing and selling the allegedly defective or dangerous product.

The Piper court further explained that the debtor's prepetition conduct gives rise to a claim to be administered in a case only if there is a relationship established before confirmation between an identifiable claimant or group of claimants and that prepetition conduct. Id.; see also Lemelle v. Universal Mfg. Corp., 18 F.3d 1268 (5th Cir. 1994) (finding that the district court erred in determining that wrongful death action brought against successor company was discharged in prior bankruptcy where there was no evidence of a prepetition relationship between the debtor and the plaintiffs).

2. Environmental Claims – As with tort claims, the potential for liability on future environmental claims should be considered by an entity interested in purchasing a debtor's assets. Courts have used the same tests discussed above when determining whether environmental claims were discharged in the debtor's bankruptcy proceeding, or whether they can be asserted against a debtor's successor:

a. Conduct test: Under this approach, a claim arises when the acts of the debtor first take place, regardless of when the costs of remediation are incurred by a claimant. See In re New York Trap Rock Corp., 153 B.R. 642, 645 (Bankr. S.D.N.Y. 1993); In re Tutu Wells Contamination Litig., 846 F.Supp. 1243, 1297 (D.V.I. 1993); In re Pierce Coal & Constr., Inc., 65 B.R. 521 (N.D. W.Va. 1986).

b. Accrual test: Under this test, a claim does not arise until all necessary acts on which the claim is based have occurred. United States v. Union Scrap Iron & Metal, 123 B.R. 831, 835 (D. Minn. 1990). Courts disagree, however, as to whether the government as claimant must actually incur costs before a claim exists in bankruptcy. See In re Nat'l Gypsum Co., 139 B.R. 397, 405 (N.D. Tex. 1992) (finding that all future clean-up costs based on a debtor's pre-petition conduct that can be fairly contemplated by the parties constitute claims under the Bankruptcy Code).

c. Noteworthy: At least one court has held that an asset purchaser cannot escape environmental liability by including language to that effect in the asset purchase agreement. Ninth Ave. Remedial Group v. Allis-Chalmers Corp., 195 B.R. 716 (N.D. Ill. 1996). Section 9607(e) of CERCLA precludes parties from determining CERCLA liability by agreement, though the parties can contract for indemnification.

3. Labor Claims – Asset purchasers may find themselves liable for labor-related claims including claims for unpaid pension plan contributions. In addition, the sale of the debtor’s assets may include the debtor’s collective bargaining agreements if the requirements for rejection are not met.

a. Pension Plan Claims – The Third Circuit’s decision in Einhorn v. M.L. Ruberton Const. Co., 632 F.3d 89 (3d Cir. 2011), has created concern that a purchaser of the debtor’s assets may be liable for the debtor’s pre-petition obligations under ERISA where (i) the buyer had notice of the liabilities prior to the sale; and (ii) there is sufficient evidence of continuity of operations between the buyer and seller. Id. at 99. The court stated that the “inquiry should be effectuated on a case by case basis balancing the equities presently before the court.” The court explained that the substantial continuity test requires courts to consider: continuity of the workforce, management, equipment and location; completion of work orders begun by the predecessor; and constancy of customers. Id. Commonality of ownership is not required. Id.

Similarly, in Chicago Truck Drivers, Helpers & Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc., 59 F.3d 48 (7th Cir. 1995), the district court dismissed a complaint brought by a pension fund against a Chapter 7 debtor’s successor seeking payment on account of the debtor’s pre-petition obligation for delinquent pension funds and ERISA withdrawal liability. The Seventh Circuit Court of Appeals reversed, finding that a blanket rule precluding all successor liability claims following a bankruptcy was untenable. The Court found it significant that the entity operating as the post-bankruptcy company was “virtually the identical enterprise” as the debtor and, therefore, the district court was not precluded from finding successor liability against the new company. Id. at 51.

- The Court explained that the successor liability doctrine under federal common law is broader than the state common law counterparts. A distinct purchaser of a business can be liable for the obligations of its predecessor if “(1) the successor had notice of the claim before the acquisition; and (2) there was “substantial continuity in the operation of the business before and after the sale.” Id. at 49 (quoting E.E.O.C. v. G-K-G, Inc., 39 F.3d 740, 748 (7th Cir. 1994)).
- The Court further reasoned that the case did not directly implicate the Bankruptcy Code because the underlying bankruptcy case had long since closed. As a result, resolution of the case turned on the doctrine of successor liability, not a specific provision of the Bankruptcy Code. Id. at n.2.

See also Upholsters’ Intl. Union Pension Fund v. Artistic Furniture of Pontiac, 920 F.2d 1323 (7th Cir. 1990) (reversing summary judgment entered in favor of defendant successor company and remanding to district court for further consideration; district court erred in ruling that labor law successorship principles could not support the imposition of liability against defendant).

Einhorn, Chicago Truck, and Artistic Furniture are distinguishable because the successor entities did not acquire the assets via a sale conducted under 11 U.S.C. § 363(f). Nevertheless, the decisions reflect a strong federal interest in protecting pension funds and enforcing ERISA.

There is some support, however, for finding that asset sales under § 363(f) can be effectuated free and clear of certain labor-related claims. See, e.g., In re Trans World Airlines, Inc., 322 F.3d 283 (3d Cir. 2003) (affirming sale free and clear of successor liability claims for employment and sex discrimination); In re Leckie Smokeless Coal Co., 99 F.3d 573 (4th Cir. 1996) (approving sale free and clear of claims for future medical benefits under the Coal Industry and Retiree Health Benefit Act).

In a relatively recent decision, the Delaware Bankruptcy Court approved the sale of the debtor's assets free and clear of a trust's successor liability claim for underfunding a pension plan. See In re Ormet Corp., 2014 Bankr. LEXIS 3071, at *7 (Bankr. D. Del. July 17, 2014). The court rejected the trust's reliance on Einhorn, Chicago Truck, and Artistic Furniture, noting that "None of them involved a sale of assets free and clear of all claims under section 363(f)." Id. at *7.

Practice pointer: With the case law being unsettled, potential asset purchasers should consider the risks of potential successor liability when formulating their auction bids, and attempt to negotiate indemnification from the debtors.

b. Collective Bargaining Agreements – When a debtor uses a unionized workforce, potential purchasers should be aware that the successful bidder may take the debtor's assets subject to the debtor's collective bargaining agreements (CBAs). For example, in In re Bruno's Supermarkets, LLC, 2009 Bankr. LEXIS 1366 (Bankr. N.D. Ala. April 27, 2009), the debtor sought to reject four CBAs, each of which contained the following successorship clause:

In the event that any or part of the assets of the employer are sold to a purchaser as a going concern, *the Employer shall require the purchaser as a condition of the sale to recognize the Union, and assume all obligations of the Employer under this Collective Bargaining Agreement* as of the sale closing date.

The debtor argued that removal of the successorship clauses from the CBAs was essential to their ability to sell the business as a going concern. The union first opposed any modification of the successorship clauses, but eventually agreed to a modification that would relieve a buyer from assuming the current CBAs if the buyer agreed to negotiate with the union to reach a new agreement with a successorship clause. Id. at * 7. The debtor continued to insist that the CBAs be rejected, and the court considered whether the debtor satisfied the elements of the Bankruptcy Code section allowing a debtor to assume or reject a collective bargaining agreement. See 11 U.S.C. § 1113.

In applying § 1113, courts agree that a debtor must satisfy the following nine elements to reject a CBA:

1. The debtor in possession must make a proposal to the Union to modify the collective bargaining agreement.
2. The proposal must be based on the most complete and reliable information available at the time of the proposal.
3. The proposed modifications must be necessary to permit the reorganization of the debtor.
4. The proposed modifications must assure that all creditors, the debtor, and all of the affected parties are treated fairly and equitably.
5. The debtor must provide to the Union such relevant information as is necessary to evaluate the proposal.
6. Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the Union.
7. At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement.
8. The Union must have refused to accept the proposal without good cause.
9. The balance of the equities must clearly favor rejection of the collective bargaining agreement.

Bruno's Supermarkets, 2009 Bankr. LEXIS, at *12 (citing In re American Provision Co., 44 B.R. 907, 909 (Bankr. D. Minn. 1984)).

The Bruno's court applied the above factors and determined that the debtor failed to establish element number eight. The union had good cause to reject the debtor's proposal to remove the successorship clauses from the CBAs, and rejection of the CBAs was denied.

B. Voluntarily Assumed Liabilities –

1. **Trade Debt** - Bidders may agree to assume certain trade debt to allow the debtor to maintain favorable relationships with suppliers, sub-contractors, and other trade creditors.

2. **Leases** – The Bidder may agree to pay cure costs so the debtor can assume and assign favorable contracts or leases:

- In In re Elcom Hotel & Spa, LLC and Elcom Condominium, LLC, Case Nos. 13-10029 / 13-10031 (BKC-RAM) (Bankr. S.D. Fla.), the Asset Purchase Agreement provided as follows:

Assignment and Assumption of Assumed Contracts. The Assumed Contracts shall be . . . assumed by the Sellers and assigned to the Purchaser at the Closing pursuant to section 365 of the Bankruptcy Code. At time of Closing, the **Purchaser** shall pay any Cure Amounts due in connection with the assumption and assignment of the Assumed Contracts, and the Purchase Price shall be reduced by the Cure Amounts. (emphasis added).

- In In re RadioShack Corp., et al., Case No. 15-10197 (BLS) (Bankr. D. Del.), the purchase price as defined in the asset purchase agreement included “the assumption of the Assumed Liabilities (**including all Cure Costs** associated with the Assigned Agreements). (emphasis added).

II. WHAT DO CONSULTATION RIGHTS REALLY MEAN?

A. The Role of the Creditors’ Committees – The legislative history of the Bankruptcy Code suggests that the drafters envisioned a prominent role for creditors’ committees in the reorganization process:

Committees will be the primary negotiating bodies for the formulation of the plan of reorganization. They will represent the various classes of creditors and equity security holders from which they are selected. They will also provide supervision of the debtor in possession and of the trustee, and will protect their constituents’ interests.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 401, 1978 U.S. Code Cong. & Admin. News 5963, 6357.

B. Committees as Fiduciaries – The first duty of a creditors’ committee is to consult with the debtor concerning the administration of the case. See 11 U.S.C. § 1103(c)(1). At all times, creditor committees act as fiduciaries for their constituents. See In re PWS Holding Corp., 228 F.3d 224, 246 (3d Cir. 2000) (recognizing § 1103(c) “has been interpreted to imply both a fiduciary duty to committee constituents and a limited grant of immunity to committee members.”); Official Comm. of Unsecured Creditors of Apex Global Info. Servs. v. Qwest Commun. Corp., 405 B.R. 234, 252 (E.D. Mich. 2009) (“participation on the unsecured committee is accompanied and undergirded with fiduciary responsibilities”); Westmoreland Human Opportunities, Inc. v. Walsh, 327 B.R. 561, 575 (W.D. Pa. 2005) (“To ensure the committee fulfills its fiduciary duty to its class of creditors requires that the committee members be candid and deal fairly among each other.”).

1. **“Consultation” does not equal “control.”** Although debtors have an obligation to consult with the creditors’ committees, debtors remain responsible for managing their day-to-day affairs. If a committee believes a debtor’s management is not fulfilling its own fiduciary duty to the bankruptcy estate, the committee should not attempt to substitute its own judgment for that of management. Instead, the committee should oppose the debtor’s actions in court or seek the appointment of a trustee. See Collier on Bankruptcy ¶ 1103.05[1][b].
 - Committees must be given sufficient information to be able to evaluate and take a position on a proposed sale of a debtor’s assets. See In re Structurlite Plastics Corp., 91 B.R. 813, 818 (Bankr. S.D. Ohio 1988) (committee was entitled to review drafts of proposed sale contracts).
 - A committee’s viewpoints should be given greater deference in a liquidating Chapter 11 case because the Bankruptcy Code’s perceived mission of aiding the economy by keeping an ongoing business afloat is not present. See In re After Six, 154 B.R. 876 (Bankr. E.D. Pa. 1993).
2. Debtors can be sanctioned for failure to timely consult with the appointed committees. See Structurlite Plastics, 91 B.R. 813, 818 (Bankr. S.D. Ohio 1988) (“If the Court is presented with *evidence* establishing an unreasonable failure by the Debtor to comply with a request by the Committee for a meeting, an order compelling the Debtor to comply with § 1103(d) will issue and appropriate sanctions will be imposed.”) (emphasis in original).
3. Members of creditors’ committees enjoy qualified immunity, analogous to that of a bankruptcy trustee, that extends to conduct within the scope of the committee’s authority. See Pan Am Corp. v. Delta Air Lines, 175 B.R. 438 (S.D.N.Y. 1994) (finding Delta failed to prove the creditors’ committee engaged in *ultra vires* action or willful misconduct); Dana Commercial Credit Corp. v. Nisselson (In re Center Teleprods., Inc.), 112 Bankr. 567, 578 (Bankr. S.D.N.Y. 1990); Central Transp., Inc. v. Roberto (In re Tucker Freight Lines, Inc.), 62 Bankr. 213, 218 (Bankr. W.D. Mich. 1986).

C. Non-Fiduciaries - Creditors acting in their own interest may also request or negotiate for consultation rights and participation in formulating the plan.

1. In re Elcom Hotel & Spa, LLC and Elcom Condominium, LLC, Case Nos. 13-10029 / 13-10031 (BKC-RAM) (Bankr. S.D. Fla.) – The hotel condominium association sought joint approval rights, not merely consultation rights, but the request was denied.
2. In re RadioShack Corp., Case No. 15-10197 (BLS) (Bankr. D. Del.) - Parties entitled to consultation included the creditors’ committee, secured parties, and the ad hoc committee of U.S. Dealers and Franchisees. Pursuant to the court-

approved bidding procedures, in the event bids were made by any member of the creditors' committee or senior secured lenders, those parties were not entitled to material, non-public information regarding competing bids. Furthermore, the debtor was not required to consult with such parties with respect to the assets for which the parties submitted a bid.

III. SALE OF CUSTOMER DATA

A. Introduction – Following the implementation of BAPCPA, a debtor with a written privacy policy may sell or lease personal information it collected from its customers only if the information can be sold in compliance with applicable non-bankruptcy law **and** (a) the sale is consistent with the debtor's privacy policy terms; **or** (b) the court approves the sale or lease after the appointment of a consumer privacy ombudsman.

B. Applicable Provisions

1. Section 107(b)(1) of the Bankruptcy Code provides that the bankruptcy court may protect an "entity" with respect to a "trade secret or confidential research, development, or commercial information." This Bankruptcy Code section mirrors Fed. R. Civ. P. 26(c)(1)(G).
2. Section 101(41A) provides the definition of personally identifiable information ("PII"):

(A) if provided by an individual to the debtor in connection with obtaining a product or a service from the debtor primarily for personal, family, or household purposes—

(i) the first name (or initial) and last name of such individual, whether given at birth or time of adoption, or resulting from a lawful change of name;

(ii) the geographical address of a physical place of residence of such individual;

(iii) an electronic address (including an e-mail address) of such individual;

(iv) a telephone number dedicated to contacting such individual at such physical place of residence;

(v) a social security account number issued to such individual; or

(vi) the account number of a credit card issued to such individual; or

(B) if identified in connection with 1 or more of the items of information specified in subparagraph (A)—

(i) a birth date, the number of a certificate of birth or adoption, or a place of birth; or

(ii) any other information concerning an identified individual that, if disclosed, will result in contacting or identifying such individual physically or electronically.

3. Section 332 of the Bankruptcy Code governs the appointment of a consumer privacy ombudsman, the purpose of which is to assist the court in understanding the effect of a sale of PII on the individuals, and assist the parties in structuring the sale so it is fair to the debtor's customers. The ombudsman can also advise the court on whether a particular sale is consistent with the debtor's privacy policy, or if the contemplated sale is "unfair or deceptive." The need for an ombudsman is implicated only if:
- The debtor disclosed a privacy policy to individuals in connection with offering a good or service;
 - The privacy policy prohibits the transfer of the PII; and
 - The privacy policy is in effect on the petition date.

C. Limitations of the PII Protections

- The information must have been provided in connection with obtaining a product or service **from the debtor**.
 - Hotel hypothetical: The debtor may provide a privacy policy when guests make reservations on the Hotel's website. In contrast, the debtor's privacy policy is usually not given when reservations are made through other websites such as Orbitz or Expedia. Then, usually only the privacy policies of those websites are given to the consumers. Arguably, the protections afforded by the Bankruptcy Code apply only with respect to the information obtained through the debtor's website, and not the information obtained through third-party conduits.
- The product or service must be obtained "primarily for personal, family or household purposes." The protections do not apply to business customers, and may not apply to information collected for advertising or marketing purposes.

D. Other Considerations

- The debtor’s privacy policy may allow for the transfer of customer information in a merger or bankruptcy sale. Many do.
- Were any changes made to the debtor’s privacy policy prepetition? (See discussion of In re Borders Group, Inc. et al. in Section E).
- Was the information legally collected, or was it done in violation of COPPA [Children’s Online Privacy Protection Act of 1998], the Gramm-Leach-Bliley Act of 1999, HIPAA, or other applicable statutes? If not legally collected, the sale of the PII would be inconsistent with applicable non-bankruptcy law and, therefore, may not be approved.
- Will the sale comply with Section 5(a) of the FTC Act prohibiting “unfair or deceptive acts or practices in or affecting commerce?”

E. Examples

1. In re Toysmart.com LLC, Case No. 00-13995 (CJK) (Bankr. D. Mass) (pre-BAPCPA) – The Debtor, selling toys over the internet, collected customer names, addresses, billing information and shopping preferences. The debtor’s privacy policy stated as follows: “personal information voluntarily submitted by visitors to our site . . . is never shared with a third party. All information obtained by [debtor] is used only to personalize your experience online.”

During the bankruptcy case, the personal data collected from customers was offered for sale. The FTC filed a complaint and reached a settlement with the debtor requiring the data be sold only in connection the sale of the debtor’s goodwill, and not on a stand-alone basis. Forty-six states, the District of Columbia, and two territories objected to the settlement, arguing that customers should be given notice and opportunity to consent before the sale is consummated. Ultimately, the debtor’s assets were not sold for lack of interest, and the FTC and shareholder/creditor Walt Disney Co. reached an agreement pursuant to which Disney agreed to pay \$50,000 for the database and then have it destroyed.

2. In re Borders Group, Inc. et al., Case No. 11-10614 (MG) (Bankr. S.D.N.Y.) - The debtor sought to sell PII collected over a period of several years, and during which time the privacy policy was amended. Information collected under the original privacy policy could not be sold without consumer consent, while the amended policy included a provision allowing the sale of PII under certain circumstances. Consumers whose information was collected under the original policy were not notified of the change, or to the fact that it would be applied retroactively. The FTC and several states’ Attorneys General raised concerns to the consumer privacy ombudsman, who recommended that the

sale take place only if certain protections were put in place. The asset purchaser, Barnes & Noble, Inc., objected to certain of the recommendations, arguing that they were unnecessary, and that the expense involved would destroy the value of the transaction from Barnes & Noble's perspective. The sale was eventually approved subject to certain conditions, including the requirement that Barnes & Noble send an opt-out notice via email to all former Borders customers whose PII was transferred. In addition, notice of the transfer and the right to opt out was required to be posted on the websites for both Barnes and Noble and Borders for a period of 30 days.

3. In re RadioShack Corp., Case No. 15-10197 (BLS) (Bankr. D. Del.) – The Debtors' online privacy policy stated that PII would not be sold. The FTC and 70% of the State Attorneys General filed formal pleadings or wrote letters to the Texas Attorney General stating opposition to the sale of PII. A Consumer Privacy Ombudsman was appointed by the court. Ultimately, the debtors agreed to mediate issues related to the sale of the PII with the auction's successful bidder.

According to court testimony, the PII included approximately 67 million physical addresses, 8.5 million email addresses, and certain data points about consumers' purchase history. At mediation, the parties reached an agreement pursuant to which the information available to potential asset purchasers would include only seven data points per customer record instead of up to 170 data points that were held by the debtor. In addition, the sale would not include debt and credit card information, telephone numbers, dates of birth, or social security numbers. Email addresses obtained over the previous two years could be sold, but customers would have the ability to opt out of communications with any successor company.

IV. CREDIT BIDDING AND LOAN-TO-OWN STRATEGIES POST-FISKER

A. Introduction — At times, parties dispute whether credit bids should be the “winning” bid even when the face amount of the debt bid exceeds the highest cash bid received. In addition, a creditor's right to credit bid was recently called into question following the decision in Fisker. Since that decision of the United States Bankruptcy Court for the District of Delaware, courts have both followed and deviated from Fisker, adding more mystery as to the extent the decision in Fisker will serve as precedent for limiting credit bidding “for cause,” or whether its application will be limited by the specific facts of the case.

B. Overview of Credit Bidding

1. Section 363(k) of the Bankruptcy Code provides that when assets to be sold are subject to a secured claim, a secured creditor may bid on the property by offsetting its claim (*i.e.*, the debt that it is owed) against the purchase price of the property being sold. This right is also preserved for secured creditors, under section 1129(b)(2)(A)(ii), where a sale of secured property occurs under

a plan of reorganization. Credit bidding allows a secured creditor to purchase property, often without having to part with new funds, and protects against the risk that such creditor's collateral will be sold at a depressed price.

2. A secured creditor's right to credit bid, however, is not absolute. Section 363(k) of the Bankruptcy Code allows the court to exercise its equitable powers to modify or deny a secured creditor's right to credit bid "for cause." What constitutes "cause" is not defined in the Bankruptcy Code and is determined on a case-by-case basis.

C. Overview of Fisker Decision

1. In re Fisker Auto. Holdings Inc., 510 B.R. 55 (Bankr. D. Del. 2014) — The court's decision in Fisker initially sent shockwaves throughout the bankruptcy community. In Fisker, prior to the petition date, Hybrid Tech Holdings, LLC ("**Hybrid**") purchased the Department of Energy's outstanding senior secured debt in the principal amount of \$168.5 million for \$25 million. Following the commencement of the chapter 11 cases, the debtors sought to sell substantially all of their assets to Hybrid (through a private sale) for consideration which included \$75 million in the form of a credit bid. The Official Committee of Unsecured Creditors opposed the credit bid and proposed an alternative — an auction with Wanxiang American Corporation ("**Wanxiang**"), whose bid contained attractive economic and non-economic terms.
2. In determining whether "cause" existed to deny Hybrid's credit bid, the court rejected Hybrid's argument that "cause" may only be triggered where inequitable conduct is present, noting that credit bidding may be denied "in the interest of any policy advanced by the [Bankruptcy] Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment." Id. at 60, n.14. Based on the circumstances of the case, the court only permitted Hybrid to credit bid the amount it *paid* for its secured debt (i.e., \$25 million) — a fraction of the principal amount of the debt (i.e., \$168.5 million). In limiting Hybrid's credit bid to \$25 million "for cause," Judge Gross emphasized the following points:
 - failure to limit Hybrid's bid would not only chill bidding, but would in fact result in no auction being held as there was no realistic opportunity for any other bidding party to bid more than Hybrid's asserted claim;
 - the presence of a highly attractive, capable and motivated competing bidder (indeed, Wanxiang had recently purchased, through a separate bankruptcy auction, a critical component of the debtors' electric cars and thus, had demonstrated a vested interest in purchasing the debtors' assets);
 - the court was also troubled by the expedited nature of the sale process required by Hybrid and originally proposed by the debtors (parties had

only 24 business days to challenge the sale motion), which was not justified in the court's eyes; and

- the Committee had raised legitimate questions as to whether (and by which assets) Hybrid's claims were secured.

D. Post-Fisker Case Law

1. In re Free Lance-Star Publishing Co., 512 B.R. 798 (Bankr. E.D. Va. 2014) — At least one court has followed the reasoning in Fisker to limit the credit bid of a secondary purchaser of debt.

- Prior to the petition date, DSP Acquisitions, LLC ("**DSP**") acquired the loan of Brach Banking & Trust ("**BB&T**"), which had provided a \$50.8 million loan to the debtors. BB&T's loans were not secured by all of the debtors' assets, and did not cover certain of the property to be sold by the debtors through the 363 sale. During the sale process, the issue arose as to the validity of DSP's right to credit bid. In limiting DSP's credit bid "for cause" shown, the court highlighted the following three points:
 - the court first held that DSP did not have valid perfected security interests in the full extent of the debtors' assets upon which DSP asserted it held liens. Therefore, DSP had no right to assert a credit bid on assets that did not secure its allowed claim.
 - the court found that DSP engaged in inequitable conduct based on the following behavior: DSP, after learning it did not have a lien on all of the debtors' assets, attempted to unilaterally expand the scope of its security interests (after the debtors refused to grant such liens) by filing certain financing statements; DSP subsequently failed to disclose such actions to the court; and DSP pressured the debtors to shorten their marketing period for the sale, and to insert language in the marketing materials conspicuously advertising DSP's credit bid rights.
 - DSP's over-zealous loan-to-own strategy chilled the bidding process in an effort to depress (rather than to enhance) the market value of the assets, which would benefit only DSP at the expense of the estate's other creditors. Therefore, the court limited DSP's credit bid "for cause" in order to attract renewed interest in the bidding process and to increase the value realized for the assets.

- Accordingly, the court limited DSP’s right to credit bid under section 363(k) of the Bankruptcy Code to \$13.9 million for assets on which DSP held valid, properly perfected liens.
2. In re RML Dev. Inc., 2014 Bankr. LEXIS 3024 (Bankr. W.D. Tenn. July 10, 2014) — At least one court has sharply departed from the Fisker ruling, holding that potentially chilling third-party bids, without more, does not constitute sufficient “cause” to limit or deny credit bidding rights. See also In re Charles Street African Methodist Episcopal Church of Boston, 510 B.R. 453 (Bankr. D. Mass. 2014) (by expressly stating that it was not addressing the “types of cause” at issue in Fisker, suggests that Fisker may have created additional categories of “cause” to deny credit bidding).
- In RML Dev. Inc., following the court’s approval of the sale of certain of the debtor’s assets (i.e., two residential apartment complexes), SPCP Group III CNI 1, LLC (“Silverpoint”) sought to amend the sale orders to allow it a right to credit bid its claim at a 363 auction. Silverpoint asserted a valid, first mortgage security interest in the two apartment complexes in excess of \$2.5 million.
 - Section 363(k) specifies that a creditor may credit bid only “an allowed claim” as defined by section 502(a) of the Bankruptcy Code. A filed proof of claim is deemed allowed until a timely objection is filed, after which there must be a hearing and determination by the court. Since RML objected to the amount of Silverpoint’s claim, the court limited Silverpoint’s credit bid to \$2,354,759.55, or the amount that RML had conceded was secured.
 - While acknowledging the right to credit bid is not absolute, the court noted that the “for cause” limitation should be the extraordinary exception and not the norm. Notably, the court rejected the proposition that potential chilling of third party bids — without more — constitutes sufficient “cause” to modify or deny a secured creditor’s rights. See id. at 155, n.11. Instead, the court held the right to credit bid should be limited or limited only in “extraordinary” cases based on equitable considerations such as “competing claims, collusion, or other fraudulent or bad faith acts.” Id. Accordingly, a creditor holding an uncontested secured claim should ordinarily be allowed to credit bid for its collateral “regardless of its intrinsic impact on other bidding.” Id.

E. ABI Commission’s Recent Recommendation on Credit Bidding and Fisker — While recognizing that credit bids may have chilling effect, the Final Report and Recommendations of the American Bankruptcy Institute’s Commission to Study the Reform of Chapter 11 (the “ABI Report”) concluded that any such chilling effect should not, by itself, yield sufficient “cause” for curbing a secured creditor’s right to

credit bid up to the amount of its allowed claim. (See ABI Report, p. 147. The ABI Report may be accessed at www.commission.abi.org.)

V. WHEN IS THE “HIGHEST” BID NOT THE “BEST” BID?

A. Introduction — If there are qualified competing bids, a debtor generally holds an auction to determine the “highest and best” bid in accordance with court-approved procedures. Debtors are given broad flexibility in determining which bid is the highest and best for the estate, and non-cash considerations may be taken into account. Parties may be motivated to prefer one bidder over another for reasons related to pending litigation, assumption of liabilities, reduction of purchaser’s claim against the estate, issues of notes or other forms of debt, adherence to a former operator’s quality standards or philanthropic mission, or even parties’ desire to employ in the future former employees.

B. Other Non-Cash Considerations — Whether the bid is subject to contingencies; extent of releases given; applicable break-up fee or expense reimbursement; modifications to previously negotiated agreements; risk of closing and/or delay; financial condition and/or experience of bidder; comments from affected parties (*i.e.*, landlords or assigned leases); approval of creditors’ committee and other constituencies.

C. Examples

1. Non-Profit Mission: In re New York City Opera, Inc., Case No. 13-13240 (SHL) (Bankr. S.D.N.Y.) — The proposed sale involved two bids between NYCO Renaissance (“**NYCO**”) and Opera New York. Despite the fact that Opera New York’s bid was \$263,000 higher, the debtor originally sought to sell its assets to NYCO as the highest bidder.² The debtor based such decision on the fact that it sought not only to maximize the value of the estate, but also to allow New York City Opera to continue its mission. The NYCO bid included detailed business plans, financial figures and evidence of future funding, a confirmed slate of directors and consultants, and evidence of venues secured for future performances. Also central to the debtor’s decision was the fact that Opera New York, though a Delaware non-profit, was not 501(c)(3) approved, and thus it was not yet clear whether it could carry on the opera’s non-profit mission.

2. Litigation Concerns: In re Elcom Hotel & Spa, LLC and Elcom Condominium, LLC, Case Nos. 13-10029 / 13-10031 (BKC-RAM) (Bankr. S.D. Fla.) — The debtor owned and operated a luxury hotel and residential complex in Miami Beach. Residents in the complex were parties to various rental management agreements (“**RMA**s”) with the debtor. These agreements provided for a reserve fund that unit owners could draw from to make

² As of the date hereof, no order has been entered approving the sale of the debtor’s assets to NYCO or any other party.

improvements to their homes. The court approved the debtor's selection of a \$13.4 million bid —notwithstanding the fact that it was \$100,000 less than the highest bid received — because it eliminated a substantial litigation risk that would have resulted from the higher bid. To that end, the winning bidder agreed to shore up the reserve fund, thereby eliminating the risk of litigation over the RMAs.

3. **Desire to Employ Former Employees:** In re WP Steel Venture LLC, Case No. 12-11661 (KJC) (Bankr. D. Del.) – Court approved sale of debtors' steel mill where the debtors, in consultation with the creditors' committee, determined that the highest and best bid belonged to the purchaser, despite the fact that the winning bid was approximately \$150,000 less in cash than the second best bid, due to the fact that the purchaser committed to using best efforts to employ at least 230 of the debtors' former employees at the facility.
4. **Third Party Consent:** In re Diplomat Construction, Inc., 481 B.R. 215 (Bankr. N.D. Ga. 2012) — The debtor owned a Red Roof Inn near Hartsfield-Jackson International Airport, leasing the land from the City of Atlanta. The trustee sought court approval to sell the debtor's interest in the lease. The State Bank of Texas, which held a security interest in the lease, consented to the sale free and clear of its lien. Thereafter, another potential purchaser presented an as-is offer that was \$70,000 higher than the original sale price. The bank did not, however, consent to this sale. With this consideration in mind, the court approved the sale at the original, lower sale price.
5. **Greater Certainty and Simplicity:** In re Scimeca Foundation, Inc., 497 B.R. 753 (Bankr. E.D. Pa. 2013) — The debtor's sole assets were various real and personal property located at the Foremost Building in Philadelphia. The trustee received an offer for \$4.377 million. The offer contained various conditions that the various financial disclosures on the property be accurate within 2% and that the purchaser obtain non-recourse financing of \$3.5 million with an interest rate of at most 4.8% with a 20-year amortization. Moreover, if the lender obtained an appraisal for less than the proposed purchase price, then the offer would be reduced to this lower value. None of these loan conditions were pre-approved. The trustee rejected this offer and instead accepted a lower proposal (for \$4 million) that had no financing contingency and for which due diligence had already been completed. In applying the business judgment test, the court accepted the trustee's decision and approved the sale.
6. **Reducing Risk of Closure:** In re Bakalis, 220 B.R. 525 (Bankr. E.D.N.Y. 1998) — The debtor sought to auction off a controlling interest in Olympian Bank ("**Olympian**"), a community bank with branches in Brooklyn and Queens. Atlantic Bank of New York ("**Atlantic**") offered \$11.2 million, while Olympian Holdings, LLC ("**Holdings**") offered \$10.5 million. To reflect the potential delay posed by regulatory approval, both Atlantic and Holdings provided an interest enhancement on the purchase price. Atlantic's

offer, however, contained several contingencies which the Holdings' offer lacked, including requirements of the absence of litigation that could materially affect Olympian, the consent of all third parties, and the absence of certain actions by Olympian's board that would adversely affect the business. The Atlantic offer also contained several walk-away clauses. By contrast, Holdings' offer was conditioned only on regulatory approval. The court approved the trustee's selection of Holdings' offer as an appropriate exercise of its business judgment considering such proposal contained fewer contingencies, and thus, posed less of a risk that the bidder would back out of the sale.

7. **Other Considerations:** In re RadioShack Corp., Case No. 15-10197 (BLS) (Bankr. D. Del.) — The approved bid and sale procedures provided as follows: “Seller’s determination of what constitutes the first and second ‘highest or best’ Bids . . . may take into consideration modifications to any Assignment Agreement, closing risk, risk of delay, financial condition, experience, use clause, comments from the affected landlord, and such other factors as Seller may deem relevant”, leaving the debtors broad latitude in determining the best offer.

VI. FINALITY OF AUCTIONS - GAP PERIOD BETWEEN AUCTION AND APPROVAL

A. Introduction — The delay between concluding an auction and obtaining court approval allows for the possibility of post-auction / pre-sale hearing bids, which may force the debtor to choose between accepting a higher and/or better offer and preserving the integrity of its auction process.

B. Recent Case Law

1. In re Sunland, Inc., 507 B.R. 753 (Bankr. D.N.M. 2014) — Hampton was the top bidder at the auction for the debtor’s processing plant. Shortly before the court’s hearing to approve the sale, the trustee received a bid from Golden Boy that exceeded the previous bid by approximately \$5 million. In balancing the two competing policies at play — maximizing creditor recoveries with preserving the integrity and finality of auctions — the court balanced the following four factors: (1) the bidding procedures and the bidders’ reasonable expectations based on those procedures; (2) the amount of the overbid and the impact on creditors; (3) whether the new bidder acted in good faith; and (4) whether a sale order had been entered. Given the amount of the overbid and Hampton’s knowledge that the auction was subject to judicial approval, the court allowed the higher post-auction bid and re-opened the auction, reasoning that the winning bid at the auction could not be approved because the court could not make a finding that a sale pursuant to that bid was in the best interests of the estate.
2. In re Western Biomass Energy LLC, 2013 Bankr. LEXIS 3166 (Bankr. D. Wyo. Aug. 6, 2013) — The liquidator sold the debtor’s assets for \$525,000.

Thereafter, but prior to the sale hearing, the debtor received an offer of approximately \$1.2 million. The court first noted that the purpose of a section 363 auction is to attain the highest and best offer for the assets sold and to serve the best interests of the estate and creditors. The court also recognized that bankruptcy courts have broad discretion to consider upset bids. With these considerations in mind, the court held that the winning bid was grossly inadequate and, when coupled with the lack of recovery for unsecured creditors, the court had sufficient grounds to deny the sale and reopen the auction.

3. In re Bigler, LP, 443 B.R. 101 (Bankr. S.D. Tex. 2010) — Four days after the auction’s close and one day prior to the sale hearing, Vopak submitted a bid \$500,000 higher than the winning \$20.5 million bid. In refusing to re-open the bidding process, the court followed the First Circuit’s approach in In re Gil-Bern Industries, Inc., 526 F.2d 627 (1st Cir. 1975), which had held that “an unimpeachably-conducted auction based on clear procedures may not be reopened solely for the reason of a higher bid after the close of the auction.”
4. In re ASHINC Corp., Case No. 12-11564-CSS (Bankr. D. Del. May 17, 2012) — Nearly two months after the auction’s close, a bidder submitted a new bid, improving on the offer he had made previously at the original auction, to purchase substantially all of the debtor’s assets. This new offer was \$30 million higher than the winning bid. The official committee of unsecured creditors moved to re-open the auction, arguing that the auction lacked fairness and transparency, which prevented the re-emerging bidder from submitting a winning bid at the time. Relying on the fact that the committee supported re-opening the auction, the court reluctantly did so.

C. Practice Pointer — While a bidder cannot avoid entirely the potential that a court may reopen an auction in order to consider a higher bid submitted post-auction, the risk diminishes if (a) the auction is conducted in accordance with the bidding procedures and in a fair manner, (b) important creditor constituencies are in favor of not re-opening the auction, and (c) the winning bid at auction is not significantly below the new overbid. The winning bidder at auction should consider requesting that the debtor make, and request that the creditors’ committee and secured lenders make, representations *at the conclusion of the auction* that such parties have no objections to the manner in which the auction was conducted and that such parties do not believe that there is cause to re-open the auction. While those representations will not be dispositive of a later motion to re-open the auction, the winning bidder will be able to argue that the debtor and significant creditor constituencies contemporaneously found the auction to have been conducted appropriately and, therefore, there is no basis to reopen the auction.

D. ABI Commission’s Recent Recommendation on Finality of Auctions — The ABI Report proposes to prohibit courts from re-opening an auction “unless the court finds extraordinary circumstances or material procedural impediments (such as the lack of adequate notice or an improperly conducted sale process) to the auction process that

may have had a material effect on the sale results.” See ABI Report, p. 139. The ABI Report further states that the potential for a higher purchase price should not, alone, constitute extraordinary circumstances sufficient to overturning an otherwise final auction. Id.