AMERICAN BANKRUPTCY INSTITUTE

2019 Annual Spring Meeting

CONCURRENT SESSION

Hosted by the Asset Sales and Ethics & Professional Compensation Committees

Not so Free, Not so Clear: An Ethical Walk Through Asset Sales

Peter J. Barrett, Moderator
Kutak Rock LLP; Richmond, Va.

Scott B. Cohen
Engelman Berger, PC; Phoenix

Peter J. Roberts
Fox Rothschild LLP; Chicago

Cynthia Romano
CR3 Partners LLC; New York

2019

NOT SO FREE, NOT SO CLEAR: AN ETHICAL WALK THROUGH ASSET SALES

ABI SPRING MEETING, WASHINGTON DC

APRIL 12, 2019

SPEAKERS:

PETER BARRETT, KUTAK ROCK (MODERATOR, VA)
SCOTT COHEN, ENGLEMAN BERGER (AZ)
PETER ROBERTS, FOX ROTHSCHILD (IL)
CYNTHIA ROMANO, CR3 PARTNERS (NY)

PRESENTATION OVERVIEW: NOT SO FREE & CLEAR

A. Section 363(f) - Successor Liability Exceptions
B. Section 363(n) - The Statutory Prohibition Against Collusion In Bankruptcy Sales
C. Statute of Limitations
D. Breaking Down the Elements of § 363(n) Collusion
E. Illustrative Collusion Cases Under § 363(n) – Clear as Day or Clear as Mud?
F. Hypothetical #1: Pit & Pendulum LLC
G. Hypothetical #2: BlueStar Airlines

NOT SO FREE & CLEAR – SUCCESSOR LIABILITY

Generally, a successor entity (or person) is not liable for the debts or liabilities or obligations of its predecessor but this general rule is not absolute. Exceptions include:

- Pre-Existing Lien Exception - is there is a pre-existing lien on the assets of a business…
  - …where purchaser expressly (or impliedly) agrees to assume such debts/liabilities;
  - …where transaction is really a consolidation or merger (i.e. the "de facto merger exception");
  - …when the purchasing corporation is merely a continuation of the selling corporation; or
  - …where the transaction was fraudulently made in order to escape liability for such debts.
- The Agreement Exception - was an affirmative statement made in the agreement?
- The De Facto Merger Exception - this will likely trigger if 3 or more of the following exist for a transaction (2 of 4 plus fair market value payment does not necessarily trigger this exception):
  - Continuation of the enterprise.
  - Continuity of shareholders.
  - The selling company ceased its ordinary business operations.
  - The purchasing company assumed the seller's obligations.
- The Mere Continuation Exception - only one company remains post asset transfer
  - There is commonality of stock, stockholders and directors between the two companies (generally owners of seller maintain a significant ownership in purchaser).

NOT SO FREE & CLEAR – SUCCESSOR LIABILITY

- The Fraudulent Transaction Exception - was the asset sale made to escape debts?
  - To avoid this exception, stock in the purchasing company can be awarded to the seller itself, not the individual owners.
  - The goal: help keep the selling company solvent for the benefit of debtors and creditors.
- Product Line Exception – a problem for some states?
  - In the case of products, this exception arises if the purchaser continues to manufacture the same product line under the same name as the seller.
  - Note that only a minority of states (California, Washington, New Jersey, Pennsylvania, Massachusetts, Michigan and Connecticut) recognize the Product Line Exception.
- Overriding Federal Policy Exception – was there awareness and substantial continuity?
  - A successor may have liability if they had notice of the claim before the acquisition and…
  - There was a substantial continuity in the operation of the business before and after the sale.
  - This includes claims related to CERCLA, NLRB, Title VII, Pensions, etc.
- The Lack of Due Process Exception
  - "Free and clear" does not bind parties in interest that did not receive appropriate notice.
  - Also affected are future claims that cannot be addressed pre-sale for which a variety of mechanisms have been employed to protect such claimants.

SECTION 363(N) – PROHIBITION AGAINST COLLUSION

- Section 363(n) of the Bankruptcy Code proscribes collusive bidding in bankruptcy sales. It provides that:

  The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

- Section 363(n)'s scope extends to all bankruptcy sales – public auctions and private sales.
- Though § 363(n) does not use the term "collusion," the legislative history of the statute reflects Congressional intent to proscribe "'collusive bidding on property.'"
- The express language of the statute proscribes "control" of a sale price through "an agreement among potential bidders" at a § 363 sale.
- The trustee may also seek punitive damages against any party that entered into the collusive agreement "in willful disregard" of § 363(n).
- The precise measure of punitive damages is left to the court's discretion based upon the particular circumstances.

STATUTE OF LIMITATIONS

- The Code is silent on the limitations period for seeking relief under § 363(n).
- Absent express limitations, courts have applied different periods depending on whether § 363(n) is invoked to avoid the collusive sale or to recover lost value.
- If the trustee chooses to avoid the sale, it should act within the one-year limitations period imposed on Rule 60(b)(3) challenges based on fraud or party misconduct.
- If the trustee chooses to recover lost value, its limitations period could be longer depending on applicable non-bankruptcy limitations statutes for analogous claims.

THE ELEMENTS OF § 363(N) COLLUSION

Express statutory language provides for three elements to a claim for relief under § 363(n) (1) **an agreement** (2) **among potential bidders** (3) **that controlled the sale price**.

1. An agreement
   - Need not be an explicit written agreement; may be oral or agreement inferred from behavior/circumstances.
   - Circumstantial evidence of parties' actions and timing of actions is often used to support inference of collusion.
2. Among potential bidders
   - Section 363(n) only applies to agreements between potential bidders.
   - Parties who individually lack resources may agree to cooperate and jointly bid without § 363(n) issues.
3. That controlled the sale price.
   - Control: an act to "exercise restraining or directing influence over;" to "regulate," "curb," "dominate," "rule."
   - Agreement controls price when (i) intended objective is to influence price, and (ii) actually does control price.
   - The Second Circuit distinguished control of a sale price from mere effect on a sale price.
   - Per the Second Circuit, control "implies more than acts causing an incidental or unintended impact on the price; it implies an intention or objective to influence the price."
   - Secret deals among bidders are typical grist for alleging collusive agreement and a consequent discussion point.

ILLUSTRATIVE COLLUSION CASES UNDER § 363(N)

- One bidder induces another bidder to drop out of the bidding so that the sale asset can be acquired at a lower price, with the two bidders sharing the difference? **Collusion**!
- One bidder agrees to withdraw its pending offer and instead pay the ultimately successful bidder for the sale asset? **No collusion!**
- Two bidders agree that one of them will drop out of bidding and retain an option to purchase the sale asset from the other if they are unable to form a joint venture after the sale? **Might be collusion.**
- Credit bidder negotiates with other bidders during auction recess and with knowledge of court in order to stimulate further bidding? **No collusion!**
- Bidder (i) drops out of negotiations for sale assets, (ii) begins negotiating with ultimately successful bidder, and (iii) buys assets from successful bidder? **Might be collusion.**

HYPOTHETICAL #1: PIT & PENDULUM LLC

- Chapter 11 Debtor tees up 363 sale for operating gravel pit and adjoining undeveloped industrial parcel.
- Bedrock Gravel bids $6MM but does not close.
- Second sale – Dino Deconstruction bids $5MM (fails to close) and BamBamPebbles (backup) backs out.
- Third attempt- Bedrock Gravel only bidder and bids $2MM.

HYPOTHETICAL #1: PIT & PENDULUM LLC

- Rumor circulates that Dino partnered with Bedrock.
- Case converts to a Chapter 7.
- Trustee files 2004 Motion followed by a lawsuit against Dino and Bedrock.

HYPOTHETICAL #1: PIT & PENDULUM LLC

- Bedrock and Dino entered into a written agreement for joint venture.
- Dino agreed not to bid.
- Bedrock agreed to bid $2MM.
- If successful, work to form a joint venture that would be owned 50/50%.
- Dino has an option to buy out Bedrock for $1MM.

HYPOTHETICAL #2: BLUESTAR AIRLINES

- Ch. 7 trustee is selling the IP assets for a regional airline company, BlueStar Airlines ("BA").
- BA is majority-owned by Y Corporate Fund ("YCF"). YCF holds a $90MM senior secured lien on BA's assets.
- Right before bid procedures/sale hearing, Flat-Top Airlines ("FTA"), owned by a corporate raider, reportedly entered into a secret deal to take over BA through the 363 sale process.

HYPOTHETICAL #2: BLUESTAR AIRLINES

- Prior litigation brought by BA against FTA alleged FTA used BA's confidential information in violation of NDAs and actively tried to harm BA's business to improve FTA's performance.
- During the BA v. FTA litigation, evidence not only backed up BA's claims, it was revealed that FTA's CFO used a computer program to delete electronic evidence.

HYPOTHETICAL #2: BLUESTAR AIRLINES

- Previously in the Ch. 7, FTA purchased the estate's claims against FTA ("FTA Claim") with a $10MM credit bid plus an agreement to turn over 5% of any recovery to the estate.
- Prior to sale/bid procedures hearing, Ch. 7 trustee learns FTA and YCP entered into an agreement: (i) the FTA Claim would be settled; (ii) YCF would use its credit bidding rights to acquire the BA IP; and (iii) YCF would then license the IP to FTA auction.
- FTA would then be able to operate as BA and FTA would pay over a portion of its income and profits to YCF over a 10 year period.

NOT SO FREE, NOT SO CLEAR: AN ETHICAL WALK THROUGH ASSET SALES

A Panel Discussion

Presented By:

Peter J. Barrett – Kutak Rock LLP

Scott B. Cohen – Engelman Berger, P.C.

Peter J. Roberts – Fox Rothschild LLP

Cynthia Romano – CR3 Partners LLC

* Materials prepared by the presenters, with additional support provided by Brian H. Richardson, Kutak Rock LLP.

4840-6034-4712.1
{0005000.0054/00959848.DOCX / 2}

COLLUSION OR NO COLLUSION?

Chapter 11 Debtor **Pit & Pendulum LLC** has filed and obtained approval to hold a Section 363 sale of its real property, which consists of an operating gravel pit and an adjoining undeveloped industrial parcel. The DIP Representative is Fred Flintstone.

At the first sale hearing, there were several bidders and the highest and best offer was determined to be **Bedrock Gravel Inc.** with a bid of **$6MM**. Thereafter, Bedrock's due diligence revealed environmental issues and Bedrock cancelled the purchase.

At a re-noticed sale hearing, the bankruptcy court found that the highest and best bid was made by **Dino Deconstruction LLC** at **$5MM**, but Dino could not get its financing in time to close. The runner up bidder, **BamBamPebbles Inc**., declined to go forward at its $4.8MM backup bid price.[1]

Frustrated but determined, P&P re-set another sale hearing. At that hearing, despite having fielded calls from all prior bidders, Debtor's counsel noted a lack of attendance. Only one bidder came forward – **Bedrock Gravel** (previous bidder) – and bid $2MM. Testimony is proffered on behalf of the Debtor that if Fred Flintstone was called to testify he would say that this property had been adequately marketed, that the sale to **Bedrock** represented the highest and best offer, and that it was an arms-length transaction. **Bedrock**'s counsel appeared and proffered testimony that if its CFO was called to testify he would say that this is an arms-length transaction and that **Bedrock** has acted in good faith. The bankruptcy judge was not impressed with P&P's continued marketing efforts, but approved the sale to **Bedrock.**

Word travels fast in the bankruptcy community. An associate at P&P's law firm overhead chatter at Flintstone's Luncheonette that led her to believe that **Bedrock** was partnering with **Dino Deconstruction** to acquire the property and celebrating their strategy that kept **Dino** out of the auction bidding but tied up their mutual interests in acquiring and developing the property. **Bedrock** was either going to make a quick return, over and above its purchase price, or co-develop the property for a song (and not "Keep on Rockin'").

After the closing, P&P converts the case to chapter 7. The chapter 7 trustee ("Trustee") proffers a Rule 2004 request on **Bedrock** and thereafter files an action against **Bedrock** and **Dino** alleging that, prior to the sale, they entered into an agreement to contrive the bidding for the P&P property.

The evidence included an agreement with the following provisions:

THIS AGREEMENT made and entered into this 3rd day of Jan. 2019, by and between **Bedrock Gravel Inc.** and **Dino Deconstruction**, for mutual consideration.

---

[1] *The Flintstones* and the characters therein are the property of Hanna-Barbera Productions, Inc. and Warner Bros. This fair use is a parody. In the history of animation, no cartoon characters have been found liable for collusively bidding at a section 363 auction sale. In fact, many cartoon characters have been quite competitive, *e.g.*, Tom v. Jerry; Bugs Bunny v. Elmer Fudd; and Road Runner v. Wile E. Coyote.

WHEREAS, **Bedrock** and **Dino** are desirous in joining forces and entering into a new joint venture to acquire the P&P real property, to be owned fifty/fifty.

NOW, THEREFORE, in consideration of the mutual covenants and agreements hereinafter set forth, the parties agree as follows:

1. **Dino** covenants that it shall not appear on the record nor make any bid for the P&P real property at the bankruptcy Trustee's Sale.

2. **Bedrock** will appear at the hearing and make an opening bid in the amount of TWO MILLION DOLLARS ($2,000,000). In the event that **Bedrock** is the winning bidder, then the parties agree as follows:

3. Within thirty (30) days of Jan. 3, 2019, the parties will work together to come to a mutually satisfactory agreement to form a joint venture entity to be owned fifty (50%) percent each....

4. **Dino** shall have the option but not the obligation to buy its 50% interest in the joint venture for $1MM.

5. In the event the parties are unable to come to a mutually satisfactory agreement on the formation of the new joint venture, the management responsibilities, and the split of profits, then and in that event, **DINO** WILL HAVE THE RIGHT TO EITHER: (1) BUY THE ENTIRE PROPERTY FROM **BEDROCK** FOR FOUR MILLION ($4,00,000.00) DOLLARS, OR (2) ELECT NOT TO EXERCISE THE BUYOUT AND IF SO, **Bedrock** shall pay to **Dino** a fee equal to $50,000 plus reimbursement of all of DINO's attorney's fees and due diligence costs incurred in the P&P bankruptcy case.

COLLUSION OR NO COLLUSION?[2]

1. What if the buyout or payment of a fee or reimbursement of fees was not included?

2. What if the Agreement was drafted but not in effect at the time of the auction?

3. What if the Agreement was drafted a day after the auction and signed after requisite board authority, two weeks after the auction?

4. What if DINO had decided before the auction that it was not interested in bidding but wanted an option?

5. What if no joint venture was ever formed under the terms of the Agreement?

6. What if Defendants elected not to exercise their $4,000,000 purchase option?

7. What if Fred Flintstone, a/k/a Twinkle Toes, and Barney Rubble, CFO of Bedrock, bowl in the same league but are not on the same team?

[2] This hypothetical is loosely based upon *In re Sanner*, 218 B.R. 941 (Bankr. D. Ariz. 1998).

8. What if, in fact, Fred and Barney are close personal friends and they discussed the sale in advance, but they both claim it was only regarding environmental concerns?

9. What if the conversations between Fred and Barney included how to obtain the lowest possible price?

Selection of Model Rules Implicated:

1. Rule 1.3: Diligence

a. Rule: A lawyer shall act with reasonable diligence and promptness in representing a client.

b. Examples in hypothetical for discussion:

i. Does the duty extend to the associate after the sale closes?

ii. Should the associate have taken immediate action after overhearing the lunch conversation rather than waiting until after the case converted to chapter 7 for the potential collusion to come to light?

iii. Can you really ever "Not look in a gift horse's mouth" when dealing with chapter 7 asset sales?

2. Rule 3.3: Candor Toward the Tribunal

a. Rule:

(a) A lawyer shall not knowingly:

(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or

(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in

criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

b. Examples for discussion:

i. The attorney at the sale hearing technically told the truth to the court. If his client's representative were to take the stand, he would say the statements that were outlined by the attorney. Did this attorney violate Rule 3.3?

ii. When you proffer testimony based on what you expect someone to say, you are representing to the court as to the veracity of the underlying statements. It is not enough to stand up and "truthfully" say that someone else would make a statement that you know to be false.

iii. What about the associate? Any independent duty on her to return to the Court with what she heard? What if she heard Fred Flintstone say statements that were directly contrary to what was proffered?

3. Rule 1.13: Organization as Client

a. Rule: (in part)

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law.

b. Examples for discussion:

i. Any duty on Bedrock or Dino attorneys in this regard?

ii. Does the Bedrock-Dino agreement violate the Bankruptcy Code in a way that would require affirmative action by an attorney?

4. Rule 3.4: Fairness to Opposing Party & Counsel

a. Rule:

A lawyer shall not:

(a) unlawfully obstruct another party' s access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value. A lawyer shall not counsel or assist another person to do any such act;

(b) falsify evidence, counsel or assist a witness to testify falsely, or offer an inducement to a witness that is prohibited by law;

(c) knowingly disobey an obligation under the rules of a tribunal except for an open refusal based on an assertion that no valid obligation exists;

(d) in pretrial procedure, make a frivolous discovery request or fail to make reasonably diligent effort to comply with a legally proper discovery request by an opposing party;

(e) in trial, allude to any matter that the lawyer does not reasonably believe is relevant or that will not be supported by admissible evidence, assert personal knowledge of facts in issue except when testifying as a witness, or state a personal opinion as to the justness of a cause, the credibility of a witness, the culpability of a civil litigant or the guilt or innocence of an accused; or

(f) request a person other than a client to refrain from voluntarily giving relevant information to another party unless:

(1) the person is a relative or an employee or other agent of a client; and

(2) the lawyer reasonably believes that the person's interests will not be adversely affected by refraining from giving such information.

b. Examples for discussion:

i. Is it fair to stand and proffer testimony that would very likely unravel under cross examination? Potential opposing parties at the sale hearing would likely not take action after hearing the proffer outlined above, but if they knew about the prior Bedrock-Dino

agreement, they would very likely want the opportunity to cross-examine the witness.

ii. Any affirmative duties to take action in this regard?

5. Rule 5.2: Responsibilities of a Subordinate Lawyer

a. Rule:

(a) A lawyer is bound by the Rules of Professional Conduct notwithstanding that the lawyer acted at the direction of another person.

(b) A subordinate lawyer does not violate the Rules of Professional Conduct if that lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty.

b. Examples for discussion:

i. Does the associate know enough information based on the lunch conversation alone to require her to take affirmative steps beyond raising the issue to a partner?

An Overview of § 363(n), the Bankruptcy Code's Anti-Collusion Provision

Peter J. Roberts, Fox Rothschild LLP

February 22, 2019

A. Section 363(n) - The Statutory Prohibition Against Collusion In Bankruptcy Sales

Section 363(n) of the Bankruptcy Code proscribes collusive bidding in bankruptcy sales. It provides that:

> (n) The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

11 U.S.C. § 363(n) (2019). Section 363(n)'s scope extends to all bankruptcy sales – public auctions and private sales alike. *See Ramsay v. Vogel*, 970 F.2d 471, 473 (8th Cir. 1992).

Though § 363(n) does not use the term "collusion," the legislative history of the statute reflects Congressional intent to proscribe "'collusive bidding on property.'" *See Lone Star Indus., Inc. v. Compania Naviera Perez Companc, (In re New York Trap Rock Corp.)*, 42 F.3d 747, 752 (2d Cir. 1994) (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess., at 346 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5963, 6302)). As the Eighth Circuit noted, collusion among prospective bidders "is precisely the evil Congress intended to deal with in § 363(n)." *Ramsay*, 970 F.2d at 474.

The express language of the statute proscribes "control" of a sale price through "an agreement among potential bidders" at a § 363 sale. 11 U.S.C. § 363(n) (2019). If those circumstances occur, a trustee can choose to (1) avoid the sale, or (2) recover the amount by which the value of the sale assets exceeds the sale price. *Id.* Either way, the trustee's litigation targets are the parties to the collusive agreement, and the trustee may recover from them any litigation costs and fees incurred in the pursuit. *Id.*

In addition to avoiding the collusive sale or recovering the value lost as a result of the collusive sale, the trustee may also seek punitive damages against any party that entered into the collusive agreement "in willful disregard" of § 363(n). 11 U.S.C. § 363(n) (2019). The precise measure of punitive damages is left to the court's discretion based upon the particular circumstances. *See Hawkins v. Eads (In re Eads)*, 135 B.R. 380, 386 (Bankr. E.D. Cal. 1991).

B. Statute of Limitations

The Bankruptcy Code is silent on the applicable limitations period for seeking relief under § 363(n). In the absence of an express limitations period, courts have applied different limitations periods depending on whether the trustee invokes § 363(n) to avoid the collusive sale or invokes it to recover the lost value from the sale. *Compare Robertson v. Isomedix (In re Int'l Nutronics)*, 28 F.3d 955, 968-69 (9th Cir. 1994) *with Sunnyside Land, LLC v. Sims (In re Sunnyside Timber, LLC*, 413 B.R. 352, 362 (Bankr. E.D. La. 2009) and *In re American Paper Mills of Vermont, Inc.*, 322 B.R. 84, 90-91 (Bankr. D. Vt. 2004). If the trustee chooses to avoid the sale, it should act within the one-year limitations period imposed on Rule 60(b)(3) challenges based on fraud or party misconduct. *See Robertson*, 28 F.3d at 968-69. If the trustee instead chooses to recover the lost value, its limitations period could be longer depending on applicable nonbankruptcy limitations statutes for analogous claims. *See Sunnyside,* 413 B.R. at 361-62; *American Paper*, 322 B.R. at 90-91.

C. Breaking Down the Elements of § 363(n) Collusion

Based on the express statutory language, courts have articulated three elements to a claim for relief under § 363(n) – (1) an agreement (2) between potential bidders (3) that controlled the sale price. *See Boyer v. Gildea*, 475 B.R. 647, 662 (N.D. Ind. 2012); *Sunnyside*, 413 B.R. at 363. Where the trustee seeks to recover damages as opposed to avoiding the sale, it must also show that the value of the sale assets actually exceeded the sale price. *See Boyer*, 475 B.R. at 663 (citing *Landscape Props., Inc. v. Vogel*, 46 F.3d 1416, 1423 (8th Cir. 1995)).

1. "[A]n agreement"

An agreement proscribed by § 363(n) need not be an explicit written agreement, but may be an oral agreement to collude or an agreement inferred from the behavior of the parties or the circumstances. *See Sunnyside*, 413 B.R. at 363. *See also NY Trap Rock*, 42 F.3d at 753 ("To the extent [DIP's] complaint alleges that it was a term of the [bidders] agreement (whether written or unwritten) that [one of the bidders] would drop out of the bidding for [the DIP's asset], the complaint alleges a prohibited voidable transaction under § 363(n)."). Trustees often must rely upon circumstantial evidence of the parties' actions and the timing of those actions to support an inference that the parties agreed to collude. *Sunnyside*, 413 B.R. at 363.

2. "[A]mong potential bidders"

Section 363(n) only applies to agreements between potential bidders. *See Tri-Cran, Inc. v. Fallon (In re Tri-Cran, Inc.)*, 98 B.R. 609, 618 (Bankr. D. Mass. 1989) (§ 363(n) was inapplicable to collusion between sole bidder and debtor in possession). Moreover, parties who individually lack the resources to bid at a bankruptcy sale may agree to cooperate and submit a joint bid without running afoul of § 363(n). *See Sunnyside*, 413 B.R. at 363. "If the purpose of the joint bid is to provide the parties with a means to participate in the sale when they otherwise would be unable to submit individual bids, the agreement likely would not support a claim under section 363(n)." *Id.*

3. That "controlled" the "sale price"

An agreement controls the sale price within the meaning of § 363(n) when (i) its intended objective is to influence the sale price, and (ii) it actually does control the sale price. *See Boyer*, 475 B.R. at 668-69; *Birdsell v. Fort McDowell Sand and Gravel*, 218 B.R. 941, 946 (Bankr. D. Ariz. 1998). Section 363(n) does not apply to "innocent" agreements that merely affect the sale price as an unintended consequence. *NY Trap Rock*, 42 F.3d at 752; *Boyer*, 475 B.R. at 662.

In *NY Trap Rock*, the Second Circuit drilled down on the element of "control" in the 363(n) context and distinguished control of a sale price from mere effect on a sale price. See *Boyer*, 475 B.R. at 662 (citing *NY Trap Rock*, 42 F.3d at 752). Starting with the dictionary definition of "control" as an act to "exercise restraining or directing influence over;" to "regulate" or "curb," "dominate," or "rule," the Second Circuit held that the term "control" as used in § 363(n) "implies more than acts causing an incidental or unintended impact on the price; it implies an intention or objective to influence the price." *Id.* (internal quotations omitted). The court concluded that its interpretation squared with Congressional intent aimed against "collusive bidding," particularly in light of the dictionary definition of "collusion" as "secret cooperation for a fraudulent or deceitful purpose." *Id.* (internal quotations omitted). *See also In re New Energy Corp.*, 739 F.3d 1077, 1079 (7th Cir. 2014) ("Collusion is a form of monopsony that depresses the price realized at auctions. . . . Not that agreement among bidders necessarily deserves opprobrium. Joint ventures have the potential to improve productivity as well as the potential to affect prices. . . .").

As the *NY Trap Rock* decision illustrates, secret deals among bidders are the usual grist for cases alleging a collusive agreement under § 363(n) and a consequent point of discussion in court decisions. *See Sunnyside*, 413 B.R. at 366 ("The failure to disclose agreements among potential bidders is a factor that the court may consider in determining whether the evidence supports an inference of collusive conduct."). In fact, as the Eighth Circuit noted, "in virtually every case in which a trustee files suit under that provision to challenge the sale of a bankrupt estate's property, the trustee will have been unaware of the alleged agreement to control the price of the property when he sought and obtained court's approval of the sale." *Vogel*, 46 F.3d at 1422.

D. Illustrative Collusion Cases Under § 363(n) – Clear as Day or Clear as Mud?

The caselaw on § 363(n) is relatively sparse and still developing. Does it provide a clear consensus on what constitutes collusion under § 363(n) and what satisfies the underlying element of "control" over the sale price? Consider the following examples drawn from the available cases:

1) One bidder induces another bidder to drop out of the bidding so that the sale asset can be acquired at a lower price, with the two bidders sharing the difference? Collusion! *See NY Trap Rock*, 42 F.3d at 753.

2) One bidder agrees to withdraw its pending offer and instead pay the ultimately successful bidder for the sale asset? No collusion! *See Vogel*, 46 F.3d at 1426-27.

3) Two bidders agree that one of them will drop out of bidding and retain an option to purchase the sale asset from the other if they are unable to form a joint venture after the sale? Might be collusion. *Sanner*, 218 B.R. at 946-47.

4) Credit bidder negotiates with other bidders during auction recess and with knowledge of court in order to stimulate further bidding? No collusion! *See In re Miami General Hosp.*, 81 B.R. 682, 688-89 (S.D. Fla. 1988).

5) Bidder (i) drops out of negotiations for sale assets, (ii) begins negotiating with ultimately successful bidder, and (iii) buys assets from successful bidder? Might be collusion. *See Boyer v. Gildea*, 374 B.R. 645, 660-61 (N.D. Ind. 2007).

HYPOTHETICAL – BlueStar Airlines[1]

Your firm has been engaged by a chapter 7 trustee ("Trustee") to handle the sale of estate assets for a regional airline company, BlueStar Airlines ("BA"). BA has been a staple #2 player in the regional airline business for many years. Lately it has fallen on hard times as competition has increased. Four years ago, it went through a chapter 11 bankruptcy, but emerged by selling off a controlling interest in its corporate stock to a lender named the Y. Corporate Fund ("YCF"), controlled by prominent British financier Sir Lawrence Wildman. Now it seems that failure is imminent as the second chapter 11 reorganization was converted to a chapter 7 liquidation.

You have lined up a potential buyer for BA's intellectual property, and an auction has been scheduled, with a hearing set a few days later to confirm the sale. Then you receive a late Friday evening phone call from a colleague "Turn on the T.V. to channel 4 news," she says. You open your laptop browser and pull up the local news website where you see a breaking news article that states "BA waves 'goodbye' as evil competitor secretly plans to steal assets." The news agency claims that Flat-top Airlines ("FTA"), which is owned by corporate raider Gordon Gekko, has entered into a secret deal to take over BA through the proposed asset sale. You scramble to investigate in advance of the sale hearing set for Wednesday.

Looking at the history of the case file, you find prior litigation between FTA and other regional airlines, including BA. The BA v. FTA litigation was previously stayed by the bankruptcy filing and, prior to your firm's engagement, the Trustee had sold the estate's potential claim against FTA (the "FTA Claim") to YCF for a $10MM credit, with a provision that 5% of any future recovery on the FTA Claim is to be paid over to the estate.

Doing a quick review of litigation documents and the record, you find that BA and another third party airline have both accused FTA of breach of confidentiality agreements. Several years ago, FTA engaged in some contract work with BA through which it obtained confidential information subject to a confidentiality agreement. Recently, as FTA increased its prominence in the regional market, BA obtained discovery of internal FTA records. BA found that large portions of the offering memoranda that FTA would use to obtain financing were lifted verbatim from the same BA documents shared previously under the confidentiality agreement. As part of the litigation, FTA filed sworn declarations from officers who stated that under no circumstances had FTA purposefully sought to drive BA out of business, and that FTA had never misused confidential information for that purpose. You find several emails in the file archive from an officer of FTA to a consultant that state "We don't want to sit back and wait for BA to die. We should be the ones to push them over the edge. Anything we can do to get BA out of the market before someone else steps in and we'll have a homerun deal." The projection documents provided from the consultant from that point forward reveal calculations of FTA growth based on BA exiting the market.

You try to pull up the email archive for another FTA officer, but only find an empty folder. In the "downloads" file, you find a file called "DiscScrubberExtreme.exe" which was recently used on the files. You also notice that the time zone on the officer's computer system is incorrect.

---

[1] Hypothetical loosely based on *in re Aloha Airlines, Inc.*, 2009 WL 1371950 (Bankr. D. Haw., May 14, 2009).

Your contact at YCF tells you that right before the auction, FTA approached them and offered to settle the FTA Claim that YCF had previously purchased. YCF agreed, and the end result was that the two companies entered into an agreement whereby YCF would be the successful bidder of the BA IP auction and sign over the rights to use the IP to FTA who would take over and operate the airline. In return, FTA would pay over a portion of the profits to YCF.

You know that YCF was authorized to use credit bidding for the auction, and there is still a $90MMoutstanding claim, all of which could be applied to the credit bid. In short, there is no possibility that any other bidder could outbid YCF at the auction.

What ethical issues are present?

Model Rules Implicated:

1. **Rule 1.3: Diligence**

   a. Rule: A lawyer shall act with reasonable diligence and promptness in representing a client.

   b. Examples in hypothetical for discussion:

      i. Settlement between YCF and FTA not known until after news agency reported it. Could this have been uncovered sooner?

      ii. Anything that could be done to further investigate FTA involvement earlier on in the asset disposition process rather than risk losing the sale of the asset?

      iii. Can you really ever "Not look in a gift horse's mouth" when dealing with Trustee sales?

2. **Rule 3.3: Candor Toward the Tribunal**

   a. Rule:

   (a) A lawyer shall not knowingly:

   (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;

   (2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel; or

(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.

(b) A lawyer who represents a client in an adjudicative proceeding and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

(d) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

b. Examples for discussion:

i. Sworn statements related to FTA intent to shut down BA

ii. Sworn statements related to confidentiality agreements

iii. Evidence that a disc scrubbing software program was used to destroy electronically stored information subject to litigation

iv. Any difference if there was a litigation notice sent to FTA to preserve documents?

v. Bring to the court's attention details of the settlement between FTA and BA as part of the sale hearing?

vi. Disclose the new information about third parties being closed out of the auction?

3. Rule 4.4: Respect for Rights of Third Persons

a. Rule:

(a) In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person, or use methods of obtaining evidence that violate the legal rights of such a person.

(b) A lawyer who receives a document or electronically stored information relating to the representation of the lawyer's client and knows or reasonably should know that the document or electronically stored information was inadvertently sent shall promptly notify the sender.

b. Examples for discussion:

i. Is this rule broad enough to require a lawyer to take action if he or she becomes aware of third parties being excluded from proceedings such as the reporter being turned away from the auction?

ii. Assuming that at some point along the way an FTA lawyer was asked to use the BA documents as a guide to prepare the FTA offering memoranda, should that lawyer have taken action if he or she knew that there was a confidentiality agreement protecting the use of the BA documents?

4. Rule 1.13: Organization as Client

a. Rule: (in part)

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.

b. Examples for discussion:

i. Any duty on YCF, FTA, or BA attorneys in this regard?

ii. Confidentiality agreements implicated here?

iii. What about for the associate representing the trustee?

5. Rule 3.4: Fairness to Opposing Party & Counsel

a. Rule:

A lawyer shall not:

(a) unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value. A lawyer shall not counsel or assist another person to do any such act;

(b) falsify evidence, counsel or assist a witness to testify falsely, or offer an inducement to a witness that is prohibited by law;

(c) knowingly disobey an obligation under the rules of a tribunal except for an open refusal based on an assertion that no valid obligation exists;

(d) in pretrial procedure, make a frivolous discovery request or fail to make reasonably diligent effort to comply with a legally proper discovery request by an opposing party;

(e) in trial, allude to any matter that the lawyer does not reasonably believe is relevant or that will not be supported by admissible evidence, assert personal knowledge of facts in issue except when testifying as a witness, or state a personal opinion as to the justness of a cause, the credibility of a witness, the culpability of a civil litigant or the guilt or innocence of an accused; or

(f) request a person other than a client to refrain from voluntarily giving relevant information to another party unless:

(1) the person is a relative or an employee or other agent of a client; and

(2) the lawyer reasonably believes that the person's interests will not be adversely affected by refraining from giving such information.

b. Examples for discussion:

i. Evidence that a disc scrubbing software program was used to destroy electronically stored information subject to litigation

ii. Any difference if there was a litigation notice sent to FTA to preserve documents?