Sales Panel

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Setting Up the Sale[1]

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I. Introduction

The courts, academic community and market commentators alike have noted the proliferation of chapter 11 cases designed to effectuate as of the commencement date section 363 sales of substantially all of the debtor's assets.[2] This evolving trend is a by-product of numerous factors including: (a) the diversification and growth of the U.S. capital markets, resulting in troubled enterprises with complex and levered capital structures; (b) misaligned incentives among capital structure participants creating a dividing line between secured creditors that are able to influence, if not direct, the outcome of a case, consistent with their contractual entitlements and less influential creditors and market participants (including potential bidders) who resist today's fast paced, sales-driven cases as antithetical to the collective and participatory

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[1] This article represents a collaborative effort by panel members and was principally authored by Marc Abrams and Gabriel Brunswick of Willkie Farr & Gallagher LLP.

[2] *See e.g.* Ralph Brubaker, *The Post-RadLAX Ghosts of Pacific Lumber and Philly News (Part II): Limiting Credit Bidding*, 34 No. 7 Bankr. L. Letter 1, 4 (July 2014) ("Two monumental developments in Chapter 11 practice that the Code drafters likely did not anticipate though, have skewed negotiations over allocation of reorganization surplus decisively in favor of senior secured creditors. . . . The first is the ascendancy of secured credit in Chapter 11 debtors' capital structures. . . . The second, related phenomenon is the rise of 'relatively expeditious going-concern sales of the debtor's business and assets to third-party purchasers' as a prominent means of realizing the debtor's going-concern value in Chapter 11.") (citations omitted).

goals of chapter 11; (c) new and often controversial practices and innovations adopted by restructuring professionals to manage or sidetrack, as the case may be, case-determinative 363 sales; and (d) a broader creeping departure from the traditional reorganization paradigm whereby chapter 11 was used holistically to provided troubled debtors with a "breathing spell" and the opportunity to propose a plan of reorganization that repositions the business enterprise and core assets in a manner designed to maximize value for the common and general benefit of all stakeholders.

In this broader context, this article discusses many of the now commonplace sales practices and innovations that have drawn the scrutiny, and in certain cases the ire, of the judiciary. This article is structured to trace the pragmatic issues arising in each phase of a 363 sale process involving substantially all of the debtor's assets from beginning to end — from deciding when to hold a sale to deciding its effect years after the closing, with other issues, notice, consent, credit bidding, and the sale's impact upon the plan (if there is one) along the way. The article will also focus on key recommendations put forward by the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 (the "Commission") in its recently published Final Report and Recommendations (the "Commission's Report," or the "Report").

II. Summary

This section will discuss the increasing pace of section 363 sales of substantially all of the debtor's assets as studied by the Commission and set forth in its Report. Because the terms and conditions of postpetition financing are often a driver of the speed at which 363 sales are executed, this section will also discuss the Commission's recommendations regarding postpetition financing as well.

III. When to have a sale?

In an ideal case, a sale of all of the debtor's assets would be held in a time and manner to maximize value for the estate while also complying with the requirements of due process. However, competing considerations such as liquidity constraints and the absence of financing sources, creditor pressure, and the professed need to preserve value in the paradigmatic "melting ice cube case" often dictate when the debtor must choose to hold the sale. As the Commission observed, practitioners seeking to harmonize these competing interests may confront devices including milestones, liquidity and budget constraints, barriers to competitive bidders in the form of bid procedures and protections, and similar sources of creditor influence that oftentimes produce unduly truncated sales processes to the exclusion of potentially more optimal restructuring outcomes.[3] As of the time of writing, *In re Relativity Fashion, LLC*[4] offers a contemporaneous example of such a scenario. This section addresses the Commission's attempts to best manage these competing concerns with regard to the timing of the sale.

A. Trend Towards Quick Sales

The Commission's Report examined the timing of sales of substantially all of a debtor's assets (called within the report "363x sales"). Given the critical importance of section 363x sales to overall recoveries of creditors, the empirical data provided by the Commission's Report should be of great use to jurists, practitioners and commentators. The Report indicates that the median number of days between the petition date and the sale order approving a section 363 sale has steadily decreased from 1989 to 2012.[5] The Commission found that, generally, section 363x sales are typically proceeding more quickly than necessary in many chapter 11 cases.

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[3] *See, e.g.*, Jessica Uziel, *Section 363(b) Restructuring Meets the Sound Business Purposes Test with Bite: An Opportunity to Rebalance the Competing Interests of Bankruptcy Law*, 159 U. Pa. L. Rev. 1189 (2011); Elizabeth B. Rose, *Chocolate, Flowers and § 363(b): The Opportunity for Sweetheart Deals Without Chapter 11 Protections*, 23 Emory Bankr. Dev. J. 249 (2006); Karen Cordy, *Rethinking § 363 Sales: ABI Commission Steps Back from Brink*, ABI Journal July 2015, Page 20, pointing to some of the most extreme examples, including *In re FCC Holdings, Inc.* in which the debtor asked the bankruptcy court to approve a sale that occurred prepetition (Dkt. No. 27), which the court denied (Dkt. No. 166). *In re FCC Holdings, Inc.*, No. 14-11987 (CSS) (Bankr. D. Del.).

[4] *In re Relativity Fashion, LLC*, No. 15-11989 (Bankr. S.D.N.Y. July 30, 2015). As of the time of writing, the Official Committee of Unsecured Creditors has just succeeded in delaying the proposed auction process (which was originally intended to be completed by September 16, 2015, 48 days following the petition date) by two weeks. *See* Jonathan Rardles, *Relativity Media Auction Postponed After Creditor Objections*, Law360 (Aug. 14, 2015, 4:31 p.m.), http://www.law360.com/articles/691337/relativity-media-auction-postponed-after-creditor-objections. In its brief, the committee argued that "Absent a level playing field to permit fair and open bidding, the [c]ommittee intends to object to the sale of substantially all of the [d]ebtors' assets to the [stalking horse] without the prior exploration of value maximizing alternatives." *Committee Objection*, at 7 (Dkt. No. 165).

[5] Report at 85.

Specifically, the Commission agreed that a quick sale may (a) not facilitate a robust auction process, (b) restrict the debtor from having sufficient time to explore a stand-alone reorganization or other restructuring alternatives, and (c) take advantage of a decline in the applicable markets without giving parties in interest a reasonable time to assess the likelihood that such markets will rebound during the pendency of the debtor's chapter 11 case.[6] Moreover, quick sales increase the potential for inadequate notice and reduced opportunity for all parties in interest to properly object to the sale, perform reliable valuations or conduct the due diligence necessary. While the Commission recognized the need to consummate a quick sale in certain circumstances (*i.e.*, a debtor's assets are of a perishable nature or otherwise subject to a rapid decline in value), the Commission found that rapid sales could potentially reduce the value available to many stakeholders in a chapter 11 case. For example, the Commission voiced a concern that rapid sales could result in a sale strategy that could suppress bidding, such as a "loan-to-own" strategy or streamlined procedures designed to chill bidding.[7]

As a result, the Commission recommended that the Bankruptcy Code should include a 60-day moratorium on section 363x sales unless it can be shown that "extraordinary circumstances" exist. Such "extraordinary circumstances" must be established under the heightened standard of clear and convincing evidence at the hearing on the motion requesting an expedited sale process.[8]

In the Commission's view, by implementing a 60-day moratorium, section 363x sales would be conducted in a more methodical manner, allowing the debtor to confirm that the sale will provide the best and highest offer for the assets and offer the best alternative for all parties in interest in cases that lack the resources for a traditional plan process that is capable of being

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[6] *Id.*; *see also* note 3, *supra*.
[7] *Id.* at 87.
[8] *Id.* at 87.

implemented as a recapitalization or an asset sale.[9] Moreover, requiring a longer process may alleviate some of the due process concerns (discussed below), as the debtor would presumably have a longer amount of time to determine the best form and manner of notice.

B. ABI Recommendations for Financing the Case

In order to allow the recommended longer runway for a sale process, the Commission's Report also put forward recommendations on financing cases, particularly the guidelines on postpetition financing terms and adequate protection. These recommendations would hopefully help provide the necessary "breathing room" for the debtor, such that it can first comply with the proposed 60-day moratorium on sales, and ultimately execute a sale process reasonably calculated to maximize value.

1. Recommendations Regarding Timing of Postpetition Financing

Consistent with the Commission's timing concerns addressed by section 363x, the Commission also recommended complementary timelines and milestones in connection with the extension of postpetition credit under section 364. In making its recommendations, the Commission cited to data provided by the Loan Syndications and Trading Association that unsurprisingly demonstrated that postpetition financing facilities with sale-oriented milestones were significantly less likely to result in a reorganization and, furthermore, such milestones typically produced the predetermined practical result: a sale. Given the clear impact that such milestones have on a debtor's reorganization efforts, the Commission made several recommendations regarding court approval of such milestones.

Specifically, the Commission recommended that a court generally not approve postpetition financing that is subject to milestones, benchmarks, or other provisions that require

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[9] Section 1123(a)(5) sets forth an array of means through which either a reorganization or a liquidating plan can be implemented, including the transfer of property of the estate, merger of the debtor, sale or distribution of property of the estate free of any liens, and the satisfaction or modification of liens.

the trustee or debtor in possession to perform certain tasks or satisfy certain conditions within 60 days after the petition date or date of the order for relief, whichever is later.[10] By generally prohibiting the imposition of such milestones prior to 60 days following the petition date, debtors are protected from arduous restrictions forcing them to market assets on a rapid, if not artificial, pace.

In addition, given the significance of such milestones, the Commission determined that such provisions in postpetition facilities should be highlighted and explained in any motion seeking approval of the postpetition financing. Moreover, such milestones should not be subject to approval in an interim order, but should only be approved on a final basis.

2. Recommendations Regarding Adequate Protection

Additionally, following a detailed review of the conceptual underpinnings and purpose of adequate protection under section 361 of the Bankruptcy Code, the Commission came to the conclusion that, under section 361, a secured creditor's interest in the debtor's property should be determined based on the foreclosure value[11] of such interest, as opposed to the more commonly used standards such as liquidation value or going-concern value.[12] The foreclosure value of the property in question should be determined on a case-by-case basis, taking into account the realities of the applicable foreclosure markets and legal considerations. By basing adequate protection on foreclosure value, as opposed to the typically higher going-concern value, the debtor's continuing adequate protection burden would be lower, thereby allowing greater ease in potentially extending the case and sale process. Despite a longer process, the secured creditor would remain protected, as the secured creditor would still be entitled to the reorganization value of its collateral upon the approval of a 363x sale. In the Commission's view, all parties in

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[10] *Id.* at 79-80.

interest would be well served in allowing a thorough process aimed at maximizing value to the estate.

IV. How to Give Notice?

As discussed above, sales of substantially all of a debtor's assets continue to be consummated in short time frames, often at the beginning of a case, pursuant to procedures that will often maximize value for the benefit of more influential creditors alone. One of the primary concerns with the expediency of such sales is the resulting effect on due process rights for adversely affected parties. Between the quick pace and sheer size of many of the recent asset sales in larger cases, courts have been faced with balancing constitutional due process concerns with the debtor's efforts to consummate a sale in the prescribed time frame.

Traditionally, courts have evaluated notice and due process requirements for creditors largely in the context of determining whether creditors are "known" or "unknown" creditors. "Known" creditors are those creditors whose names and addresses are known or otherwise "reasonably ascertainable" to the debtors through a search of their books and records.[13] If, however, the debtor cannot reasonably obtain the information though its own books and records, and the party does not have a pending claim against the debtors, publication notice is generally sufficient.

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[11] Foreclosure value is defined in the Report as "the value that a secured creditor's state law foreclosure efforts would produce if the automatic stay were lifted or the bankruptcy case had not been filed." *Id*. at 71. However, if the debtors are able to show adequate protection by virtue of the existence of an equity cushion (*i.e*., the difference between the foreclosure value and the value a secured creditor would receive upon a 363 sale), then the adequate protection order should grant the secured creditor the right to insist upon a 363 sale by the debtor if the debtor's reorganization efforts fail. For a more detailed discussion of the spectrum of values between pure liquidation and going concern, *see generally*, *In re Phoenix Steel Corp.*, 39 B.R. 218 (Bankr. D. Del. 1984); Christopher S. Sontchi, *Valuation Methodologies: A Judge's View*, 20 AM. BANKR. INST. L. REV. 1 (2012).
[12] Report at 71.
[13] *In re Motors Liquidation Co.*, 529 B.R. 510, 547 (Bankr. S.D.N.Y. 2015); *Chemetron Corp. v. Jones*, 72 F.3d 341 (3d Cir. 1995).

However, in the context of section 363 sales, this distinction is only the first step in the inquiry. As illustrated recently in the *Motors Liquidation* case (discussed below), courts must also examine the circumstances surrounding the sale and the debtors as a whole. In certain instances, the "known" vs. "unknown" difference may not be readily apparent, and the court must canvas the entire case records to determine whether notice will be sufficient under the circumstances. By doing so, courts can be expected to respect the "flexible" nature of the due process analysis.

In addition, courts must also examine whether the affected party has suffered any prejudice as a result of a due process violation. In determining whether notice is proper, courts must balance two core interests: the protections of due process guaranteed under the Constitution and the necessity of finality in sale orders. Given the necessity of preserving finality in sale orders, courts have carefully analyzed the prejudice suffered by the procedurally deprived party to determine whether the sale order must be selectively modified or enforced to remedy the due process defect. By focusing on the actual harms, courts may be able to largely preserve the finality of the sale order while also recognizing due process defects and reacting accordingly.

Judge Gerber recently addressed all of these issues in a challenge to the 2009 sale order issued in the dramatic bankruptcy of General Motors.

A. *In re Motors Liquidation Co.*

1. Background

Motors Liquidation Co., formerly known as General Motors Corp. ("Old GM"), famously filed for bankruptcy on June 1, 2009, after receiving emergency loans from the United States Treasury. Slightly more than one month later, Old GM sold substantially all of its assets to a new holding company backed by the American and Canadian governments, called General

Motors LLC ("New GM"). As a part of the sale, New GM agreed to assume some but not all, of the liabilities of Old GM — the liabilities not assumed by New GM stayed with Old GM, and per section 363(f) of the Bankruptcy Code, New GM took the assets "free and clear" of all successor liability. While New GM did agree to assume all future (*i.e.*, injury sustained post-sale) personal injury claims arising out of GM cars, whenever manufactured, it did not agree to assume all potential causes of action that could arise from vehicles manufactured and sold by Old GM. (Section IX of this article will discuss the impact of these free and clear provisions of section 363(f) in more detail.)

However, as was later revealed, personnel at Old GM and personnel who migrated to New GM were aware at the time of the bankruptcy that certain ignition switch defects existed in GM vehicles dating back to the 2005 model year. Despite this knowledge, owners of cars with the ignition switch defects (estimated at 27 million vehicles) were not given individual mailed notice of the 363 sale, mailed notice of the opportunity to file proofs of claim, or provided recall notices as required under applicable statutory law. The only notice these car owners arguably received in connection with entry of the sale order was a notice of the proposed sale published in various newspapers by Old GM.[14]

Subsequently, in March 2014, New GM announced to the public the ignition switch defects.[15] Following this announcement, New GM issued a recall of the affected vehicles. Thereafter, numerous plaintiffs filed class action lawsuits across the country seeking economic loss on various theories, including compensatory damages, punitive damages, RICO damages and attorney fees in connection with the ignition switch defects (the "Economic Loss Plaintiffs"), or personal injury claims based on accidents prior to the closing of the New GM sale (the

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[14] *Motors Liquidation*, 529 B.R. at 547.
[15] *Id.* at 521.

"Accident Plaintiffs").[16] After the various class actions were consolidated for joint pretrial administration in a multidistrict litigation in the United States District Court for the Southern District of New York, New GM moved for an order enforcing the 2009 sale order before the bankruptcy court.

2. Holding and Rationale

Judge Gerber, who presided over Old GM's bankruptcy and issued the 2009 sale order, also presided over the 2015 motion to enforce that same sale order. In his opinion, Judge Gerber believed he was confronted with four issues: (a) whether notice of the sale order as to the plaintiffs was sufficient for procedural due process purposes; (b) to what extent an aggrieved individual's lack of prejudice from insufficient notice matters; (c) what remedies are appropriate for any due process denial; and finally (d) to what extent sale orders can be modified after the fact at the expense of those who purchased assets from an estate on the expectation that the sale order would be enforced in accordance with its terms.

The court began by acknowledging the common due process principle that actual notice is typically required for "known" creditors, whereas constructive notice is typically acceptable for "unknown" creditors. However, the court also analyzed the due process requirements with an awareness of both precedents, acknowledging the need for practical considerations in evaluating due process and the specific context of the sale process in question, which required completion on an expedient basis before Old GM "ran out of money." As a result of the extraordinary circumstances surrounding the GM bankruptcy, effectively requiring approval of a sale within 40 days of the petition date, the court recognized that publication notice to current vehicle owners

[16] A third group of plaintiffs, who did not have cars with ignition switch defects, but nevertheless claimed damages due to the damage to the GM brands caused by the ignition switch defects, also brought claims, but these claims were not adjudicated in the April 15, 2015 decision. Subsequently, on May 27, 2015, Judge Gerber held that the April 15, 2015 decision was *state decisis*, and thus applied the same distinction between Old GM conduct and New GM conduct described below to the plaintiffs who did not have cars with ignition switch defects. *In re Motors Liquidation Co.*, 531 B.R. 354 (Bankr. S.D.N.Y. 2015).

was "obviously proper" and "essential."[17] It was simply impractical, given the time exigencies, to expect Old GM to mail out notices to all vehicle owners. In doing so, the court consistently stressed the "flexible" nature of the due process standard, noting that adequacy of notice must be evaluated in the context of the surrounding circumstances. However, the court also had to determine whether the knowledge of many Old GM personnel of the ignition switch defects "removes this case from the general rule," rendering publication notice improper in such circumstances and instead requiring Old GM to send out mailed notices to those parties that Old GM knew would be affected by ignition defects. The court ultimately reasoned that, because many of Old GM's personnel were aware of the ignition switch defects, Old GM also knew that mailed recall notices were required to be sent out under the National Traffic and Motor Vehicle Safety Act. As a result, those car owners required to receive the recall notice were "known" creditors, and the court held that Old GM was required to mail notices to those car owners whose identities were known as a result of the ignition switch defects.

However, while the notice was ultimately insufficient for due process, the plaintiffs also had to show prejudice from this lack of notice. Here, the court found that the different classes of plaintiffs suffered varying degrees of prejudice. Specifically, the Accident Plaintiffs who had suffered accidents prior to the closing of the sale were not prejudiced at all from the defective notice, primarily because they were well represented at the time of the original sale and were unable (in the court's view), even years later, to make any new arguments regarding the scope of the sale order. The court had heard the same arguments in 2009 with respect to the free and clear language in the sale order and successor liability concerns as it was now hearing in 2015, and "neither [p]laintiff group has advanced any arguments on successor liability that were not

[17] *Motors Liquidation*, 529 B.R. at 521.

previously made, and made exceedingly well before."[18] As a result, the free and clear language as to successor liability with respect to both sets of plaintiff classes applied because "even where inadequate notice has been given, prejudice is an essential element for vacating or modifying an order implementing a 363 sale."[19]

However, the Economic Loss Plaintiffs were prejudiced in part, but only because they were unable to argue at the sale hearing that the proposed sale order was overly broad — the sale order should have clarified that parties were allowed to assert new economic claims involving vehicles manufactured by Old GM as long as such claims were based solely on New GM's conduct. As a result of such prejudice, those plaintiffs were entitled to a remedy, and the court held that those plaintiffs asserting economic loss could assert otherwise viable claims against New GM for any causes of action that might exist arising solely out of New GM's independent actions. (While not discussed in the opinion itself, presumably these actions could include New GM's continuing failure to issue the recall notice, which presumably could have contributed to the extent of economic losses suffered by the Economic Loss Plaintiffs.)

The court recognized the due process violation as a constitutional violation which, therefore, must trump the principles underlying the finality of 363 orders. Thus, the court held that in order to remedy any due process defects, a sale order may be modified or selectively enforced in order to provide an aggrieved party with a proper remedy.

3. Post-Decision Developments

Following his decision in April, Judge Gerber entered a judgment on June 1, 2015,[20] which sets out which suits were barred by the original sale order, as well as establishing a procedure for the class action plaintiffs to challenge his determination. Subsequently, the

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[18] *Id.* at 565.
[19] *Id.*
[20] Judgment, *In re Motors Liquidation Co.*, No. 09-50026 (Bankr. S.D.N.Y. June 1, 2015) (Dkt. No. 13177).

plaintiffs moved to withdraw the reference of Judge Gerber's determination of whether a specific party was barred by the original sale order, and have that determination instead made by a district court judge. New GM, however, challenged that motion on the ground that the June 1, 2015 judgment barred parties from seeking to withdraw the reference. On August 13, 2015,[21] Judge Gerber ruled that while GM was correct that certain language in the June 1 judgment appeared to bar plaintiffs from withdrawing the reference, the constitutional concerns over the bankruptcy court's jurisdiction most recently articulated by the Supreme Court in *Wellness International Network, Ltd. v. Shariff*[22] required him to interpret his own order to allow the district court to determine if the reference should be withdrawn. Subsequently, on September 21, 2015,[23] Judge Furman, judge of the MDL litigation in the Southern District of New York denied the withdrawal of the reference, finding that withdrawal of the reference was neither required, nor warranted under the circumstances, and allowed Judge Gerber to continue to determine which suits were barred by the original sale order.

4. Observations

In making its ruling, the court placed great importance on the underlying circumstances surrounding the sale, including the emergency cash infusions by the U.S. government and the requirement that Old GM be sold in 60 days or less. Under such circumstances, the notice protocol would have been reasonable if it had not been that Old GM personnel knew of the ignition defects and did not send out the required notices. This article will return to a discussion of *In re Motors Liquidation Co*. with regard to its implications concerning the "free and clear" provisions of section 363(f).

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[21] Bench Decision and Order on New GM's Motion to Enforce Judgement Stay on Motions to Withdraw Reference, *In re Motors Liquidation Co.*, No. 09-50026 (Bankr. S.D.N.Y. Aug. 13, 2015) (Dkt. No. 13374).
[22] 135 S. Ct. 1932 (2015).
[23] *In re Motors Liquidation Co.*, No. 15-4685, 2015 BL 277473 (S.D.N.Y. Aug. 27, 2015).

V. Who consents? (Following proper notice)

In order to sell property free and clear of interests, a trustee or debtor in possession will need to meet one of the five conditions set forth in section 363(f). Section 363(f) provides that a trustee or debtor in possession may sell property free and clear[24] of interests if:

> (1) applicable nonbankruptcy law permits sales of such property free and clear of such interest;
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> (2) such entity consents;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
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> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f).

Questions may arise when the debtor attempts to satisfy section 363(f)(2) by implied consent of creditors through a failure to object to the proposed sale. Essentially, the debtor will argue that a failure to object is equivalent to acquiescence and, therefore, "consent" under section 363(f)(2). In certain instances, courts may find "consent" through absence of objection, provided, of course, that notice is proper.[25] However, courts continue to grapple with this issue based on the facts and circumstances presented in the sale at issue. As illustrated recently in the

[24] The meaning of the phrase "free and clear" has proven difficult to define, as will be discussed in section IX.

[25] *See, e.g.*, *FutureSource LLC v. Reuters Ltd.*, 312 F.3d 281, 285 (7th Cir. 2002) ("It is true that the Bankruptcy Code limits the conditions under which an interest can be extinguished by a bankruptcy sale, but one of those conditions is the consent of the interest holder, and lack of objection (provided of course there is notice) counts as consent."); *Christ Hosp. v. Hudson Hosp. Pro Pco, Inc. (In re Christ Hosp.)*, No. 14-472 (ES), 2014 WL 4613316, at *14 (D.N.J. Sept. 12, 2014) ("Silence by affected claim holders may constitute consent for purposes of section 363(f)(2).").

Arch Hospitality[26] case, the nature of the claim at issue can also be a determining factor when weighing whether silence equates with consent under section 363(f)(2).

A. In re Arch Hospitality, Inc.

1. Background

Arch Hospitality, Inc., was a hotel that filed for chapter 11 in May 2012. A year and a half into the case, the debtors found a prospective buyer willing to purchase the hotel for $1.75 million. However, this purchase price was significantly below the aggregate value of the outstanding liens consisting of: (a) real property taxes in excess of $234,000; (b) TD Bank's first liens on the real estate and personal property, worth more than $2.9 million; (c) Buffalo Realty Corp.'s second mortgage on the real estate, which was in excess of $477,000; (d) New York State Department of Taxation and Finance liens on account of unpaid taxes for over $40,000; and (e) a $2,500 judgment of the New York State Worker's Compensation Board.

Even though the secured indebtedness exceeded the sale offer, the debtors wanted to close the sale at the contract price and filed two motions to proceed. The first sought to avoid the liens of Buffalo Realty, the New York State Department of Taxation and Finance, and the Worker's Compensation Board as wholly unsecured pursuant to section 506(a) of the Bankruptcy Code and thus void pursuant to section 506(d) of the Bankruptcy Code. The second motion sought authority under sections 363(b) and 363(f) of the Bankruptcy Code to sell the hotel property free and clear of all liens.

2. Holding and Rationale

Chief Judge Bucki began by citing the relevant sections of the Bankruptcy Code on which the debtors' arguments relied. Under section 506(a), a creditor's allowed claim secured by a lien on property is unsecured to the extent that the value of the creditor's interest is less than

[26] *In re Arch Hospitality, Inc.*, 530 B.R. 588 (Bankr. W.D.N.Y. 2015).

the amount of the claim. Section 506(d) states that a lien is void to the extent that it secures a claim against the debtor that is not an allowed secured claim. Because the real property taxes and TD Bank's first mortgage exceed the value of the hotel, the debtors contended that the remaining junior liens were all void. The debtors argued that the sale of the hotel was therefore permissible under section 363(f), which allows a trustee to sell property free and clear of any third-party interests in the property if, among other possibilities, the third party consents (section 363(f)(2)) or the interest is a lien worth less than the sale price (section 363(f)(3)) such that the lienholder in question will be fully satisfied.[27]

Of the five lienholders on the property, only the rights of two were in dispute.[28] Specifically, the court had to address whether Buffalo Realty and the Worker's Compensation Board also consented to the sale of the hotel. Neither party responded to the debtors' sales motions; only the U.S. Trustee appears to have filed an objection. The debtors argued that by failing to respond, those creditors gave their implied consent to the sale under section 363(f)(2). The court rejected this argument and held that Buffalo Realty and the Worker's Compensation Board did not consent to the sale of the hotel by not responding to the sale motion. According to Chief Judge Bucki, "a failure to oppose . . . differs fundamentally from an affirmation of acquiescence."[29]

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[27] The courts are in fact split on this question, with some courts finding that 363(f)(3) allows a sale when the sale price is above the *allowed* amount of the secured creditor's lien (as determined by a section 506(a) appraisal of the value of the collateral) but still less than the *nominal* amount of the lien. *Compare.*, *WBQ P'ship v. Va. Dep't of Med. Assistance Servs. (In re WBQ P'ship)*, 189 B.R. 97, 105-06 (Bankr. E.D. Va. 1995) (used the allowed amount of the lien for purposes of 636(f)(3)), *and In re Beker Indus. Corp.*, 63 B.R. 474, 475-76 (Bankr. S.D.N.Y. 1986) (same), *with Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25, 40-41 (B.A.P. 9th Cir. 2008) (using the nominal amount of the lien for 363(f)(3) purposes).

[28] The proposed sale would generate sufficient proceeds to pay the real property taxes in full as required under section 363(f)(3). TD Bank, the first mortgagee, expressly consented to the sale, and the New York State Department of Taxation and Finance implicitly consented by withdrawing its objection to the sale after receiving adequate assurances of payment of its claim by a third party. Both creditors' consents satisfied the requirements of section 363(f)(2).

[29] *Arch Hospitality*, 530 B.R., at 591.

The court acknowledged that there are circumstances where silence could indicate consent. For example, in *FutureSource LLC v. Reuters Ltd.*,[30] a failure to object counted as consent when the affected interest was a license to use intellectual property. But, in Judge Bucki's view, the sale of real property was a different situation. Specifically, the court noted that Buffalo Realty was a mortgagee of record and that the Workers' Compensation Board had a recorded judgment: "Both creditors took the necessary steps to perfect their liens. Having perfected their liens, both could understandably expect that their interests would survive any subsequent transfer of title. Under these circumstances, the more reasonable inference is that silence would here imply the absence of consent."[31]

The court relied on the reasoning in two decisions: *In re Roberts*,[32] and *In re DeCelis*.[33] In *Roberts*, the court concluded that a failure to object did not imply the consent required under section 363(f)(2), even when the lienholder received adequate notice. The court stated that the word "consent" means "to give assent or approval"—which is not synonymous with "fails to object."[34] Specifically, the court declared that section 363(f)(2) requires express consent from the lienholder. Similarly, in *DeCelis*, the court held that a property could not be sold free and clear of a co-owner's interest because the co-owner did not affirmatively consent to the sale of assets and the co-owner's failure to respond to the motion to sell did not constitute consent. The *Arch Hospitality* court agreed with *Roberts* and found that the Bankruptcy Code does not impose a duty to respond to notices. If Congress had intended silence to constitute consent in the context of section 363(f)(2), it would have so stated. Having found that two creditors had not consented

[30] 312 F.3d 281.
[31] *Arch Hospitality*, 530 B.R. at 591.
[32] 249 B.R. 152 (Bankr. W.D. Mich. 2000).
[33] 349 B.R. 465 (Bankr. E.D. Va. 2006).
[34] *Roberts*, 249 B.R. at 155.

to the extinguishment of their liens, Judge Bucki thus denied the motion to sell the hotel free and clear under section 363(f).

3. Observations

Arch Hospitality should stand as a warning to practitioners that sometimes only "yes" means yes. While the case remains a minority position for section 363 sales,[35] practitioners should be careful when dealing with fully perfected lienholders. Similarly, while not in the context of a sale, the Second Circuit just recently held in a different case that the Bankruptcy Code required something more than mere silence by a perfected secured creditor in a case before a plan could extinguish that creditor's liens under section 1141(c).[36] Specifically, a secured creditor's lien would be extinguished if "(1) the text of the plan does not preserve the lien; (2) the plan is confirmed; (3) the property subject to the lien is 'dealt with' by the terms of the plan; and (4) the lienholder participated in the bankruptcy proceedings." While the extent of lienholder participation required under prong (4) of the new test was not fully established, the Second Circuit nonetheless noted that, at a minimum, the participation requirement "requires more than [the lienholder's] mere passive receipt of effective notice" that a plan might deal with its lien. As was the case in *Arch Hospitality*, when dealing with a perfected secured creditor, only "yes" meant yes.

VI. How much can they bid? (Credit bidding)

Ultimately the debtor, while in possession of estate property and the holder of the right to sell it, will have to confront the practical challenges of having to manage the rights of additional holders of interests that define and limit the debtor's rights as the legal owner with remedies that may yield actual ownership in the form of perfected secured creditors. The Bankruptcy Code

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[35] *See* note [25], *supra.*
[36] *City of Concord, N.H. v. N. N.E. Tel. Operations LLC (In re N. N.E. Tel. Operations LLC)*, No. 14-3381, 2015 WL 4619576 (2d Cir. Aug. 4, 2015).

provides a number of protections for a secured creditor's ownership interest, including the right to bid the amount of its secured claim at any auction under section 363(k). This right to bid the amount of its secured claim, known as "credit bidding," acts to protect the value of a secured creditor's property interests. The Supreme Court's 2012 opinion in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*,[37] while technically a case about plan confirmation, was seen by many as reaffirming the importance of a secured lender's section 363(k) right to credit bid. However, under section 363(k), the court may limit a secured creditors' credit bidding right for "cause." Questions remain for both courts and practitioners as to how to best conduct an auction where a secured creditor has the right to credit bid — and when "cause" exists to curtail that credit bidder's rights.

A. Hypothetical: When the Whole Is Worth More Than the Sum

As an example of the practical challenges of credit bidding, how should an auction be conducted when there are multiple creditors that have the right to credit bid on different assets, which, while technically severable, are worth more as a whole than as the sum of the parts? To illustrate, consider a hypothetical debtor whose primary assets are 12 ships. Each ship is secured by a single lien, held by one of four secured creditors. Each of the four secured creditors has the sole lien on three separate vessels, securing $10 million per ship. The ships, however, each have an appraised value of $8 million, which is $2 million less than the current value of the liens on each ship individually. The debtor, however, has identified a stalking horse bidder that is willing to bid $108 million for the full fleet of 12 ships, but is interested only in purchasing the entire fleet. One of the secured creditors, however, objects to this proposed sale, arguing that since it will not be paid in full, it has the right to bid its full $30 million against the three ships on which it has a lien, which, so far as its three ships are concerned, is a higher and better offer than the

[37] 132 S. Ct. 2065 (2012).

stalking horse bidder for the estate. Perhaps the secured creditor believes that the valuation of its ships was done improperly, has resources to realize a better price than the current debtors, or even bought the debt from the original lender at a discount as a way to cheaply acquire the ships for its own operation. Can the bankruptcy court confirm the sale of all of the ships over the objection of the dissenting secured creditor that wishes to buy its ships now?[38]

A distinct but similar issue arises with regard to holdouts under syndicated loans. Specifically, majority holders of a syndicated loan can often exercise the right to credit bid the entire loan over the objection of dissenting noteholders, so long as the underlying credit documents authorize such an action.[39] However, such issues may turn on the precise language of the credit agreement in question.

Other issues, such as the validity of the liens in question and the seemingly minor actions by the secured creditor in the lead-up to the auction, can create problems for judges and practitioners in credit bidding. Judge Gross in *In re Fisker Automotive Holdings, Inc.*[40] confronted these sorts of pragmatic issues.

B. *In re Fisker Automotive Holdings*

1. Background

In *Fisker Automotive*, debtor, a plug-in hybrid car company, declared bankruptcy after a safety recall of its batteries, the loss of substantial inventory due to Hurricane Sandy, and the

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[38] Recently, Judge Jones in a concurrence to *In re RL Adkins Corp.*, raised three hypothetical scenarios, two of which are similar to this hypothetical at issue. 784 F.3d 978, 982 (5th Cir. 2015). While she did not provide "definitive answers to the hypotheticals," Judge Jones expressed concerns as to whether a secured creditor's right to credit bid can actually be preserved in a bulk sale of assets with multiple liens held by different lienholders. *Id.*

[39] *See*, *e.g.*, *In re GSC, Inc.*, 453 B.R. 132, 173 (Bankr. S.D.N.Y. 2011) (finding that prepetition credit agreement gave controlling lender, not agent, the right to determine the amount to credit bid, and that dissenting lenders' dispute was under the prepetition credit agreement, not the credit bid itself); *In re Metaldyne Corp.*, 409 B.R. 671, 678-79 (Bankr. S.D.N.Y. 2009) (finding that prepetition credit agreement gave agent the right to direct the credit bid over objection of dissenting debtholders). *See also* Arthur J. Gonzalez, Robert D. Drain, James M. Peck, Marc Abrams, and Michael L. Bernstein, *Intercreditor Issues and Subordinate Financing: "Tranche Warfare." Bankruptcy Court Jurisdiction over Intercreditor Issues and Subordinate Financing Agreements*, 100110 ABI-CLE 33, 49-55 (Oct. 1, 2010).

[40] 510 B.R. 55 (Bankr. D. Del. 2014).

withdrawal of the lending facility provided by the U.S. Department of Energy (the "DOE"). Upon filing, the debtors owed a little over $200 million to their creditors, of which approximately $169 million was senior secured debt originally provided by the DOE. A little more than a month before the petition date, Hybrid Tech Holdings LLC ("Hybrid")[41] purchased all of the DOE debt for approximately $25 million. Hybrid then entered into discussions with the debtors to enter into a quick bankruptcy and sale of all of the debtors' assets to Hybrid for a credit bid of $75 million. The debtors decided that a quick sale to Hybrid, without a competitive auction process, was the course of action most likely to create the most value for the estate.

The unsecured creditors' committee challenged the proposed sale, and Judge Gross prepared to hold a hearing on the sale motion. However, a competing bidder, Wanxiang, offered an attractive bid, which led the debtors and the committee to enter into a stipulation on the day of the hearing. In this stipulation, the debtors and the committee agreed that: (a) if Hybrid's right to credit bid were limited to $25 million or removed completely, the resulting auction would have a material chance of creating value for the estate greater than Hybrid's current $75 million bid; (b) there would be little chance of a competitive auction if Hybrid's credit bid rights were not capped; (c) limiting the right to credit bid would foster a competitive bidding environment; (d) a sale of all of the assets of the estate as a totality would create the most value; and (e) material amounts of the debtors' assets were not subject to perfected liens, and were subject to bona fide dispute. Based on these stipulated facts, the debtors and the committee moved for the court to find that either: "(i) credit bidding should not be permitted here given that a material portion of the assets to be sold in their entirety are not subject to a property perfected lien in favor of Hybrid or are subject to lien in favor of Hybrid which is in bona fide dispute, which

[41] While not discussed in the opinion, Hybrid Tech Holdings LLC was allegedly controlled by an insider of the debtors. *See Omnibus Objection*, No. 13-13087 (Bankr. D. Del. Dec. 30, 2013) (Dkt. No. 264).

dispute cannot be quickly and easily resolved or (ii) 'cause' exists because limiting the credit bid will facilitate an open and fully competitive cash auction or (iii) 'cause' exists because the Debtors' assets to be sold in their entirety include encumbered, unencumbered and disputed assets."[42] The committee did not ask that credit bidding be limited for any other reason.

2. Holding and Rationale

Judge Gross began his discussion by noting that absent cause, a secured creditor is granted the right to credit bid under section 363(k). Thus, Hybrid would be granted a right to credit bid at least some amount; the question was how much. Judge Gross noted that the factual record was clear and uncontested that if Hybrid's right were not curtailed, no auction would actually take place. The court's concern went beyond the mere risk of seeing the bidding process "chilled" by Hybrid's credit bidding rights. "Thus, the 'for cause' basis upon which the court is limiting Hybrid's credit bid is that bidding will not only be chilled without the cap; bidding will be frozen."[43] Judge Gross went on to note other aggressive tactics used by Hybrid to prevent a competitive auction, including scheduling key response and hearing dates immediately before and after the Thanksgiving and New Years holidays. No explanation was provided for why such an accelerated sale process of a non-operating debtor was required. Judge Gross would not allow the use of such tactics to "short circuit the bankruptcy process."[44]

Judge Gross also disposed of an argument of Hybrid to extend the holding of *In re Submicron Systems Corp.*,[45] which, Hybrid argued, allowed it to bid the full amount of its secured claim, notwithstanding that certain of its liens were unperfected or subject to bona fide dispute. Judge Gross distinguished *Submicron*, pointing out that the nature of the dispute at issue

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[42] *Fisker Automotive Holdings*, 510 B.R. at 58.
[43] *Id.* at 60.
[44] *Id*. at 61.
[45] 432 F.3d 448 (3d Cir. 2006).

was not whether the collateral in question had any value (which was the issue in *Submicron*), but instead whether Hybrid's claim was in fact an allowed secured claim at all. Judge Gross thus limited Hybrid's right to credit bid to $25 million.

3. Post-Decision Developments

Hybrid filed an emergency motion for direct appeal to the Third Circuit following Judge Gross's decision in the bankruptcy court. The district court denied all of Hybrid's motions, initially noting that "This barrage of 'emergency' motions" (Hybrid had filed three motions in four days) "of dubious merit and even more doubtful urgency has served only to unnecessarily burden the court and impede resolution of Hybrid's contentions regarding the bankruptcy court's credit bid order." Ultimately the district court found that Judge Gross's order was not a final order subject to appeal and that Hybrid could not show any of the factors necessary for the court to grant leave for interlocutory appeal or direct appeal.[46]

Following the denial of Hybrid's appeal-related motions, the auction of the debtors' assets went forward over three days, between February 12 and 14, 2014. Wanxiang emerged as the winning bidder, for approximately $149.2 million made up of $126.2 million in cash, $8 million of assumed liabilities, and a 20% equity stake in the acquired assets. This winning bid represented a significant increase in value over Hybrid's initial $75 million credit bid.

4. Observations

As is clear from *Fisker Automotive*, a judge's ability to limit a secured creditor's right to credit bid for "cause" is a powerful tool when confronting issues around a sale involving a potential credit bidder. *Fisker Automotive* represents a confluence of two typical kinds of

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[46] *See Hybrid Tech Holdings, LLC v. Official Comm. of Unsecured Creditors of Fisker Auto. Holdings (In re Fisker Auto. Holdings)*, No. 14-cv-00099 (GMS), 2014 WL 546036 (D. Del. Feb. 7, 2014) (denying Hybrid's motion for leave to appeal); *Hybrid Tech Holdings, LLC v. Official Comm. of Unsecured Creditors of Fisker Auto. Holdings (In re Fisker Auto. Holdings)*, No. 14-cv-00099 (GMS), 2014 WL 576370 (D. Del. Feb. 12, 2014) (denying Hybrid's motion for direct appeal to Third Circuit).

"cause" that can arise in a credit bidding context: disputes as to the value of the liens in question and overzealous attempts by the secured creditor to control (if not dominate) the auction process. There are, however, alternative approaches that practitioners can propose to address some of these issues, rather than directly limiting a secured creditor's credit bid rights. *In re RML Development, Inc.*[47] provides an example of how an escrow can be used as a creative solution where the validity of the secured lender's lien is in dispute.

C. *RML Development*

1. Background

The debtor, RML Development, Inc. ("RML"), owned two residential apartment complexes in Memphis, Tennessee. Two creditors claimed to have secured liens against the properties: Silverpoint, who held a secured claim in the form of a promissory note and deed of trust worth roughly $2.5 million; and Slawomire Wisniewski ("Wisniewski"), who asserted a purportedly superior claim on the theory of a prior constructive trust worth approximately $3.9 million.

What further complicated this dispute was the fact that one of RML's shareholders, Roman Sledziejowski ("Sledziejowski") had also filed for bankruptcy in the Southern District of New York. The trustee in Sledziejowksi's case, Marianne O'Toole ("O'Toole") alleged that Sledziejowski had in fact been operating a Ponzi scheme.

When RML originally filed its section 363 motion to sell the apartment buildings, Silverpoint and O'Toole objected. After RML withdrew and revised its section 363 motion, the court entered an order allowing the property to be sold free and clear of all interests. While the court later approved two separate sales of the two properties, the sales failed to close.

[47] 528 B.R. 150 (Bankr. W.D. Tenn. 2014).

Silverpoint subsequently moved for modification of the sales procedures order to expressly allow it to credit bid.

By the time of the motion, RML had already filed its objection to Silverpoint's claim, contesting the calculation of interest, past payments and fees, but admitting that roughly $2.3 million of the claim should be allowed. Additionally, Silverpoint, Wisniewski and O'Toole were in the process of settling their claims, but had yet to finalize their settlement.

2. Holding and Rationale

The court, relying in part on *Fisker Automotive*, found that a creditor's section 363(k) rights to credit bid should be restricted only when "equitable concerns give it cause" and that such restrictions should "be the *extraordinary exception* and not the norm."[48] In a footnote, the court voiced its disagreement with *Fisker Automotive* and *Free Lance-Star* (discussed below), which in the court's view had held that the mere chilling effect of credit bidding was sufficient to restrict a secured creditor's credit bidding rights. "This court is convinced that, where a creditor holds an uncontested secured claim, it should ordinarily be permitted to bid at a § 363 sale of its collateral regardless of its intrinsic impact on other bidding."[49] Here, given the dispute around Silverpoint's claim and the priority of its lien, the court found that there was sufficient cause to restrict Silverpoint's credit bidding rights. The court thus required that Silverpoint place in escrow any bid made over the roughly $2.3 million that RML had admitted was valid. Finally, the court ordered that if the settlements with Wisniewski and O'Toole were not finalized and completed by the sale date, Silverpoint would have to provide a letter of credit, surety bond, or similar instrument in the amount of its proposed credit bid, so that the court could later

[48] *Id.* at 156 (Emphasis added).
[49] *Id.* at 155 n. 11.

adjudicate Wisniewski's and O'Toole's objections to Silverpoint's lien and have recourse to substitute consideration.

3. Observations

RML shows how creative solutions, such as the use of an escrow, letter of credit, or surety, helped to simplify what could have easily become a messy and complex dispute over Silverpoint's right to credit bid. While concerns of fraud and creditor misconduct were likely ever present in the court's mind given the nature of the Ponzi scheme allegations made against Sledziejowski, simplifying the issue for purposes of the sale was clearly in the best interests of the estate and likely all parties concerned.

When potential creditor misconduct has tainted the auction process itself, however, more drastic measures may need to be taken to restore bidder confidence. *In re Free Lance-Star Publishing Company. of Fredericksburg, VA*[50] is an example of a case where the secured creditors' actions in helping to set up the auction led to a more forceful curtailment of their credit bidding rights.

D. *Free Lance-Star*

1. Background

The debtors, *The Free Lance-Star Publishing Company of Fredericksburg, VA* and its affiliates (collectively, "Free Lance-Star"), owned and operated both a printing and a newspaper business, as well as four radio stations. In 2006, to expand its business, Free Lance-Star entered into a secured loan for approximately $50.8 million, with certain assets as collateral. Explicitly left out of the collateral pool were three parcels of real property containing radio broadcast towers (collectively, including the towers themselves and related permits, the "Tower Properties"). Using the proceeds of the secured loan, Free Lance-Star constructed a new printing

[50] 512 B.R. 798 (Bankr. E.D. Va. 2014).

facility, which opened in early 2009, at the height of the recession. The company was shortly in breach of certain covenants under the secured loan and entered into a forbearance agreement with its original secured lender in December 2011. In 2013, the secured loan was sold to Sandton Capital Partners ("Sandton") for an undisclosed amount, who subsequently transferred the loan to an affiliate, DSP Acquisition, LLC ("DSP").

Shortly after purchasing the loan in June of 2013, Sandton informed Free Lance-Star that it wanted the company to file chapter 11 and execute a section 363 sale to DSP. DSP then began to request that the Tower Properties be added to the pool of collateral backing the secured loan. The parties began talks regarding a bankruptcy filing, but negotiations broke down in mid-August. DSP then unilaterally filed a financing statement in an attempt to perfect a security interest in the broadcast towers. The parties resumed negotiations in late September, with DSP then intending to acquire a security interest in the Tower Properties through a DIP loan postpetition. The parties began to draw up marketing materials for the section 363 sale, which would conspicuously advertise DSP's ability to credit bid up to $39 million (presumably the amount of the original $50.8 million loan outstanding). However, as negotiations continued, Free Lance-Star developed cash flow projections indicating that the company could finance the bankruptcy without the need for a DIP loan. DSP objected to these projections, and negotiations broke down entirely before Free Lance-Star filed for bankruptcy in late January 2014.

After the filing, DSP sought to acquire a security interest in the Tower Properties as adequate protection for Free Lance-Star's use of DSP's cash collateral, but did not disclose to the court that it had already filed financing statements against these assets. The judge denied DSP's motion for adequate protection. Free Lance-Star then sought to conduct two separate section 363 sales of its business assets and the Tower Properties. On March 10, 2014, the bankruptcy court approved Free Lance-Star's sales procedure motion, which allowed any secured creditor with valid liens (as determined consensually or by the court) to credit bid. On that same, day DSP filed an adversary complaint seeking to establish the validity of its liens on all of the assets of Free Lance-Star, including the broadcast towers. The judge ruled that DSP lacked a valid or perfected lien on certain of Free Lance-Star's assets, including the Tower Properties. Free Lance-Star then moved to limit DSP's right to credit bid.

2. Holding and Rationale

Free Lance-Star advanced three arguments for restricting DSP's right to credit bid: first, DSP should obviously not be allowed to credit bid against assets in which it held no security interests; second, DSP's conduct was inequitable and had dampened interest in the auction process; and third, removing DSP as a potential credit bidder would enhance the auction process and yield a greater realization from the sale.

The judge agreed with the debtors that DSP obviously could not credit bid against assets in which it did not have a valid lien. The judge was also deeply troubled, given DSP's obvious and aggressive loan-to-own strategy, that DSP failed to timely disclose to the court that it had previously filed financing statements. Additionally, relying in part on *Fisker Automotive*, the judge found that DSP's right to credit bid did indeed chill enthusiasm for the bidding process, noting that only one other potential bidder had at that point conducted a site visit of the properties. Finally, the judge was also convinced by Free Lance-Star's expert, who had testified that an appropriate cap on DSP's right to credit bid would facilitate a competitive auction.

The judge thus ultimately ruled that "[t]he confluence of (i) DSP's less than fully-secured lien status; (ii) DSP's overly zealous loan-to-own strategy; and (iii) the negative impact DSP's misconduct has had on the auction process has created the perfect storm, requiring curtailment of DSP's credit bid rights."[51] The judge thus limited DSP's right to credit bid to $13.9 million.

3. Observations

Free Lance-Star arguably goes further than *Fisker Automotive*. Unlike *Fisker Automotive*, which relied upon a combination of the secured creditor's bad faith along with a real uncertainty as to the validity of the liens to find cause, *Free Lance-Star* (after discounting the portion of the secured creditor's liens that were entirely unperfected) appeared to find further cause on the basis of the secured creditor's aggressive strategy, which had resulted in a chilled (but not frozen) bidding environment. *RML Development* does appear to disagree with *Free Lance-Star* (and arguably *Fisker Automotive*) as to whether the impact of a secured creditor's credit bidding rights on the auction can (absent dispute over the validity of the liens) constitute cause for restriction.

E. Hypothetical: Estoppel by Bid

Actions by secured creditors in the lead-up to a sale will always have a reputational impact in terms of their credibility before all parties involved, including judges. However, it remains an open question whether their actions as credit bidders can affect their actual legal rights as creditors later in the case. As an example of this sort of "estoppel by bid," consider a secured creditor who has a valid and perfected lien on some, but not all, of the debtor's assets. This secured creditor, however, wishes to make a bid at an upcoming section 363 auction, which will consist of a combination of all of its credit bidding currency, cash, and stock. Unfortunately for the credit bidder, it loses the auction to a cash and stock bidder who offered even more than the credit bidder's combined offer. After the sale closes, is the credit bidder, by virtue of its combined cash and stock bid, now estopped from later objecting that a combination of cash and

[51] *Id.* at 807.

stock is not the indubitable equivalent of its secured claims? Or may the creditor argue that its actions as a credit bidder should have no affect on its status as a secured creditor?

F. ABI Commission Recommendations Regarding Credit Bidding

The Commission considered the recent developments in cases like *Fisker Automotive* and *Free Lance-Star*, and the concern those cases raised about the ability of a secured creditor to use credit bidding rights to chill the auction process. While acknowledging that all credit bidding chills auctions to some extent, the Commission also noted that some of this chilling effect comes not only from the right to credit bid itself, but also from the conduct of the secured creditor, which contributes to a less rigorous auction process. Alluding to the secured creditor's heavy-handed behavior in *Free Lance-Star*, the Commission's Report noted examples of a secured creditor demanding a short marketing period and an insistence by a secured creditor on marketing materials that put front and center the secured creditor's right to credit bid. Thus, the Commission recommended that the current cause standard under section 363(k) be retained. However, it agreed that the mere chilling effect of a credit bid should not constitute cause, but that courts should attempt to limit the chilling effect of credit bidding (such as extending the length of the marketing period).

VII. What comes next? (Structured dismissals and other sales without a plan)

In many cases, knowing what comes after the sale will be of key import. Is the debtor planning to truly reorganize as a smaller company after selling off a major division? Will the debtor instead create a liquidating plan following the sale? Or, will no plan be confirmed following the sale, leading the case to be either converted to a chapter 7 or dismissed entirely?

The last option has become an increasingly attractive one in cases where the court issues an order enforcing actions taken during the case, and does not (as is typically required under section 349) return all parties to the *status quo ante*. These dismissals, called "structured dismissals," grant additional flexibility to all parties but have received criticism for contributing to the avoidance of the plan process or the use of chapter 7 at the inception of the bankruptcy proceeding. If the case is ultimately going to end in a dismissal, the sale process is far more likely to ultimately resolve the central issues of the case without customary procedural and disclosure safeguards or compliance with the Bankruptcy Code's distribution scheme.

The Third Circuit recently became the first of the circuit courts to approve structured dismissals in *In re Jevic Holding Corp.*[52] While the Third Circuit stressed that such a disposition was justified only in "rare" circumstances, it nonetheless found that the circumstances at issue justified a departure from the typical bankruptcy process. *Jevic* addressed the question in the context of a non-sale related litigation settlement, but it is likely to apply to future cases where there is a sale and dismissal as well.

A. *In re Jevic Holding Corp.*

1. Background

The debtor, Jevic Transportation, Inc. (together with its parent holding company, Jevic Holding, Inc., "Jevic"), was a New Jersey-based trucking company purchased by the private equity firm Sun Capital Partners ("Sun") in 2006 through a leveraged buyout. Sun financed the purchase with a group of lenders led by CIT Group/Business Credit Inc. ("CIT"). Jevic, however, was unsuccessful under new ownership, eventually having to cease operations and lay off all of its employees on May 19, 2008. The next day Jevic filed a voluntary petition under chapter 11 in the Delaware Bankruptcy Court. At the time of the filing, Jevic owed approximately $53 million to Sun and CIT, both of whom held a first-priority lien on almost all of Jevic's assets. Other creditors, who held tax and general unsecured claims, were owed

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[52] 787 F.3d 173 (2015).

approximately $20 million, and their interests were represented by the official committee of unsecured creditors.

Two groups filed lawsuits during the bankruptcy case. First, Jevic's recently terminated truck drivers (the "Drivers") filed a class action complaint against the company and Sun, alleging violations of federal and New Jersey labor laws[53] requiring 60 days' written notice before lay-offs. While Sun was ultimately deemed not an employer of the Drivers and thus not liable, the bankruptcy court eventually found that Jevic had indisputably violated the New Jersey labor laws, giving rise to a claim estimated to be worth $12.4 million, of which $8.3 million was likely entitled to special priority status given to certain employee wage claims under the Bankruptcy Code.

Concurrently, the unsecured creditors' committee also brought a suit against Sun and CIT on behalf of the estate on a number of legal theories, including allegations of fraudulent conveyance and preferential transfer, both of which survived a motion to dismiss in 2012.[54] Before the Drivers established the liability of Jevic for their claims, however, the committee, Jevic, CIT and Sun negotiated a settlement agreement. Under the terms of the proposed settlement: the parties would execute mutual releases; the fraudulent conveyance and preference actions would be dismissed; CIT would contribute $2 million to an account to pay Jevic and the unsecured creditors' committee's legal fees and administrative expenses; Sun would transfer its lien on Jevic's only remaining assets ($1.7 million in cash)[55] to a trust set up to first pay administrative and tax creditors, followed by unsecured creditors on a pro rata basis; and then the entire bankruptcy case would be dismissed. This settlement would in effect be a classic example

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[53] These worker protections are called the Worker Adjustment and Retraining Notification ("WARN") Acts. *See* 29 U.S.C. § 2102; N.J. Stat. Ann. § 34:21-2.
[54] The Committee also made claims for state law fraudulent conveyance, equitable subordination, and aiding and abetting breach of fiduciary duty, which the bankruptcy court dismissed without prejudice.
[55] All of *Jevic's* other assets had been liquidated to pay CIT.

of a “structured dismissal,” in which settlements reached during the bankruptcy case survive notwithstanding the dismissal of the case, instead of restoring the parties to their status before the filing.

The Drivers’ claims (most of which likely would have been treated as employee wages to be paid before tax and general unsecured creditors under the normal priority rules of section 507) were not included in the settlement for reasons not immediately clear from the record. It appears that while the Drivers participated in the discussions leading up to the settlement, they were unable to reach an agreement with Sun, their opponent in the then still pending labor class action. Sun eventually conceded that it was unwilling to fund a litigation against itself, and thus insisted that the Drivers not receive a portion of the settlement.

The Drivers and the U.S. Trustee objected to the proposed settlement. Both argued that the settlement denied the Drivers their statutory protections as priority wage claimants. The Drivers also argued that they had been betrayed by the unsecured creditors’ committee, which had breached its fiduciary duty to the Drivers by agreeing to a settlement that froze them out. The U.S. Trustee opposed the settlement on the additional ground that structured dismissals were not authorized under the Bankruptcy Code.

The bankruptcy court, in an oral opinion, overruled all of the objections and approved both the settlement and the dismissal. The bankruptcy court noted the “dire circumstances” of the debtor meant there was essentially no chance for a reorganization. Any recovery for the unsecured creditors by other means was unlikely: if the case were converted to chapter 7, the estate’s assets would consist of only the $1.7 million in cash, upon which Sun held a lien, and the claims against Sun and CIT. The court determined that a chapter 7 trustee would most likely lack the funds to further litigate the claims, and would likely simply turn over the cash and close the case. Essentially concluding that the settlement was better than any likely alternative (where all unsecured creditors, including the Drivers, would receive nothing), the bankruptcy court approved the settlement.

The Drivers then appealed to the U.S. District Court for the District of Delaware.[56] The district court affirmed[57] and the case was appealed again to the Third Circuit.

2. Holding and Majority Rationale

By the time the case reached the Third Circuit, the Drivers and the U.S. Trustee had refined their arguments. They did not contest the factual findings of the bankruptcy court, or even its exercise of discretion, but instead argued that structured dismissals were either banned entirely by the Bankruptcy Code, or had at least to comply with the priority distribution scheme provided by the Bankruptcy Code.

Judge Hardman, writing for the majority, acknowledged a lack of specific statutory authorization for structured dismissals in the Bankruptcy Code, but also noted that the code allows a bankruptcy judge to modify the typical return to the prepetition status quo provisions of a dismissal for "cause." The majority stressed that the Drivers themselves had admitted that no plan could be confirmed, and that a conversion to chapter 7 would benefit no one. Therefore, the majority did not address the possibility that a structured dismissal would be used to create a *sub rosa*, or secret, plan that circumvented the procedural and substantive requirements of the chapter 11 plan process. The court thus held that "absent a showing that a structured dismissal

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[56] The Drivers simultaneously moved before the bankruptcy court to have the implementation of the settlement stayed pending appeal before the district court, which the bankruptcy court denied. The Drivers did not renew their request for a stay before the district court, and the settlement closed several months later.

[57] *Czyzewski v. Jevic Holding Corp. (In re Jevic Holding Corp.)*, No. 13-104-SLR, 2014 WL 268613 (D. Del. Jan. 24, 2014).

has been contrived to evade the procedural protections and safeguards of the plan confirmation or conversion processes, a bankruptcy court has discretion to order such a disposition."[58]

The majority then addressed the Drivers' argument that even if a structured dismissal is allowed under the Bankruptcy Code, such a dismissal must respect the standard priority scheme of section 507. Here the majority noted a disagreement between the Fifth and Second Circuits as to whether a court could approve a settlement that did not respect the standard priority scheme — though neither case addressed this question in the context of a structured dismissal.

The Fifth Circuit, in *In re AWECO*, *Inc.*,[59] adopted a per se rule prohibiting settlements that did not respect the standard priority scheme, and rejected a settlement of a lawsuit against the debtor that would have transferred $5.3 million of estate assets to an unsecured creditor, before payment had been made to the secured creditor.

The Second Circuit, however, in *In re Iridium Operating LLC*,[60] criticized the earlier *AWECO* holding and instead adopted a more flexible rule. The Second Circuit panel in *Iridium* (which included then Judge, now Justice Sotomayor) was asked to approve a settlement in which half of the settlement funds would be provided to the secured lenders, while half would be provided to a trust set up to fund a litigation against Motorola, which happened also to be an administrative creditor of the debtor. The remaining creditors (except for Motorola) would then receive the proceeds of the liquidation (if any) and/or any leftover funds. Motorola had objected to the settlement on the ground that it violated the normal priority scheme. The Second Circuit held that while compliance with the normal priority rules for distribution was "the most important factor" to consider when approving a settlement, a settlement can nonetheless be approved when the normal priority distribution scheme was not followed, provided "the

[58] 787 F.3d at 182.
[59] 725 F.2d 293, 295-96 (1984).
[60] 478 F.3d 452 (2007).

remaining factors weigh heavily in favor of approving a settlement."[61] The Second Circuit then found that while the litigation trust structure was justified in this instance, the rules for how the trust assets were to be distributed after the end of the litigation (namely to the exclusion of Motorola) was not justified. The Second Circuit thus only approved denying Motorola its share of the settlement while the litigation against it was pending, and remanded back to the lower court for further findings on how the funds should be distributed after the litigation against Motorola was complete.

The Third Circuit was persuaded by the reasoning of *Iridium* and adopted what it determined was a more flexible standard than the per se rule of *AWECO*, one that would aid parties in crafting settlements. Like the Second Circuit in *Iridium*, the majority held that courts could approve settlements that deviate from the standard priority scheme only when they have "specific and credible grounds to justify the deviation."[62]

The majority then went on to find that the bankruptcy court had sufficiently justified the deviation (providing for the payment of certain administrative and unsecured creditors while not providing for any distribution to the Drivers on account of their priority wage claim) from the standard priority scheme in approving the settlement. Alluding to the fact that it does not review findings of fact *de novo*, the majority found that, on the record provided, the bankruptcy court was in a situation where there was no alternative that would have provided some recovery to any creditors other than CIT and Sun. Thus, while "a close call," the majority found that the bankruptcy court was correct to approve the settlement and structured dismissal.

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[61] *Id.* at 464.
[62] *Jevic*, 787 F.3d at 184 (citing *Iridium*, 478 F.3d at 466).

3. Dissent

Judge Scirica dissented from the majority's opinion, finding that while the majority was correct to adopt the flexible standard for approving settlements from *Iridium*, the special circumstances required by *Iridium* were not present in *Jevic*. Judge Scirica first noted that the prospect of a chapter 7 liquidation was mostly a result of Sun's unwillingness to allow estate funds to be used in the litigation by the Drivers. Judge Scirica was more concerned, however, that while the deviation from the priority scheme did increase the recovery of some creditors, it did not increase the value of the estate overall. *Iridium*, in Judge Scirica's view, was an example in which a more minor deviation was justified by the goal of maximizing the total recovery of the estate. For Judge Scirica, the bankruptcy court in *Jevic* had not made it sufficiently clear how deviating from the standard priority scheme increased the recovery of the estate. Judge Scirica would have remanded, with instructions to redistribute the proceeds of the debtors' settlement in accordance with the standard priority scheme, but otherwise leaving the settlement in place.

4. Observations

Jevic makes the Third Circuit the first of the Circuit Courts of Appeals to approve the use of a structured dismissal as an alternative to conversion of a case to chapter 7 or the dismissal of a case that returns all parties to their status quo. While many have raised concerns over the practice, the majority's decision unquestionably grants additional flexibility to courts and parties in interest in crafting settlements and resolving chapter 11 cases, at least in the Third Circuit and in other circuits and courts that follow the reasoning of *Jevic* and *Iridium*. The concerns raised by the speed at which section 363 sales are conducted have just as much in force with regard to structured dismissals — are certain creditors abusing the process to their benefit in cases that should likely have been chapter 7 liquidations at the inception. Future cases likely will provide additional guidance regarding the substantive limits of structured dismissals and whether the practice is able to expand beyond the "rare" circumstances described by the majority in *Jevic*. One such case, *In re ICL Holding Co.*,[63] illuminates for practitioners just how much courts are willing to tolerate the practice.

B. *In re ICL Holding Company*

1. Bankruptcy Court Decision

ICL Holding Co., an operator of acute care facilities, filed for chapter 11 in December 2011, and immediately began to seek a sale of all of its assets. The only bidder at the auction was Hospital Acquisition Corp., which made a credit bid. The ultimate bid, however, contained a $3.5 million cash payment to the official committee of unsecured creditors, which had agreed to withdraw all objections to the perfection of the secured creditor's liens and the proposed sale. Some proceeds of the sale were also set aside to pay the professionals of debtor and committee. The U.S. Trustee, however, objected to the sale, noting that the sale and settlement structure would bypass the I.R.S.'s administrative tax claim. As in *Jevic*, all parties agreed that an ultimate plan was unlikely.

At the sale hearing,[64] Judge Gross found the settlement with the unsecured creditors needed additional notice and removed it from the proposed sale order, asking the parties instead to propose it as a post-sale settlement motion. He, however, also found a sound business purpose for the sale, and that the sale was proposed in good faith.

Subsequently, at the hearing to approve the separate settlement, Judge Gross found that the key issue was whether the settlement with the unsecured creditors constituted property of the estate such that the absolute priority rule was implicated. He stated on the record that:

[63] *In re ICL Holding Co.*, No. 14-2709 (3d Cir. May 16, 2014).
[64] *In re ICL Holding Co.*, No. 12-13319, Apr. 2, 2013 Hr'g Tr. (Bankr. D. Del.) (Dkt. No. 615).

> [T]he secured lender-purchaser funding this proposed settlement doesn't have a responsibility to make certain that administrative claimants are paid or other parties are paid and it has entered into what it deems to be a reasonable settlement from its vantage point. I'm having difficulty seeing where an objection to bidding procedures in which the creditors committee raised the possibility of a challenge to liens equates to property of the estate. I just don't believe that's the case. A challenge wasn't filed. A complaint was[n't] filed. There was no proof shown to parties or indication shown to parties that, in fact, any of the liens could be challenged or could be successfully challenged. It was simply an allegation that we often see from creditor[s'] committees in an effort to achieve what this creditors[s'] committee has achieved, namely some money going to creditors, unsecured creditors and that's what happened.[65]

Thus, because the value of the claim held by the debtors (namely the lien challenge) was of little to no value, Judge Gross found that the $3.5 million payment to the unsecured creditors, as well as the escrow for professionals and wind-down costs, was not property of the debtors' estate, and so did not implicate absolute priority concerns.[66] Judge Gross also denied the federal government a stay of his order pending appeal.

2. Appeals

On appeal to the district court, Judge Robinson affirmed Judge Gross's findings regarding both whether the $3.5 million was property of the estate and the denial of the stay order with little discussion of the non-procedural issues. The U.S. government then appealed to the Third Circuit. At oral argument,[67] the panel viewed the case as raising a number of substantive issues: first, were the payments property of the estate; second, did the absolute priority rule apply to sales; and third, if the absolute priority and unfair discrimination rules did apply, could the "gifting doctrine" be invoked to allow the distribution outside of the priority scheme?

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[65] *In re ICL Holding Co.*, No. 12-13319, May 23, 2013 Hr'g Tr. at 74 (Bankr. D. Del.) (Dkt. 799).
[66] Because Judge Gross was addressing a settlement and sale, not a plan, he did not need to confront *In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir. 2005), which would have prohibited the "gift" to the unsecured creditors in violation of the absolute priority rule. *See also*, *In re DBSD North America, Inc.*, 634 F.3d 79 (2d Cir. 2011).
[67] *In re ICL Holding Co.*, No. 14-2709, Oral Arguments (3d Cir. Jan. 14, 2015).

While deciding any of these issues could have provided much needed guidance for future cases, ultimately the Third Circuit decided[68] only the first issue.[69] Both the $3.5 million dollar payment to the unsecured creditors, and the escrow set aside for the payment of professionals and wind down costs were not, ultimately, property of the bankruptcy estate and thus did not implicate *any* distribution requirements of the bankruptcy code. The Government contended that the $3.5 million dollar payment to unsecured creditors represented an increased bid for government assets, and thus should constitute estate property, the Third Circuit was not convinced, and held that because the cash never entered the estate, and the payment was not made at the debtor's direction, the payment could not be considered property of the estate. Similarly, while the escrowed funds, set aside for the payment of professional and wind-down fees were in fact explicitly listed as consideration for the sale, and arguably thus estate assets, the economic reality of the sale transaction, and the structure of the escrow (unused funds would be returned to the secured creditors) lead the Third Circuit to conclude that the escrowed funds were not estate property.

The Third Circuit did not fully address what it considered the second key question: namely if the sale and settlement had involved estate property, would the sale and settlement have to comply with the ordinary priority scheme, specifically the absolute priority and unfair discrimination rules? However, in even phrasing this question, the Third Circuit may have

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[68] *In re ICL Holding Co.*, No. 14-2709, 2015 BL 295784 (3d Cir. Sept. 14, 2015).

[69] The Third Circuit, as a preliminary matter, also found that the appeal was not constitutional, statutorily, or equitably moot. Specifically, the court first found that the government's chance to prevail, while remote, was still significant enough to prevent the appeal from being constitutionally moot. Second, section 363(m), which limits appeals that affect the validity of a sale where the purchaser acted in good faith, did not apply. While the debtors and the committee argued that 363(m) rendered the challenge to the sale order statutorily moot, as the escrowed funds were a "fundamental term" of the transaction, the Third Circuit instead held that the section only applied when resolving the appeal in question would result in a claw back of the purchased property. Where, as was the case, the appeal could be resolved without unwinding the sale completely, section 363(m) did not apply. Finally, the Third Circuit held that the doctrine of equitable mootness only applied in a plan context, and so was not applicable to an appeal of a sale order and settlement.

signaled its view, by noting that most of distribution requirements of the bankruptcy code (except for section 507) textually only applied in a chapter 11 plan context.[70]

C. What is "highest and best" when an offer will pay someone besides the estate?

ICL Holding ultimately raises the key question: What is the highest and best offer for the bankruptcy estate when the proceeds of that offer will flow to a party other than the estate? ICL only had a single bidder, but what if a competing offer paid the estate $1 million more, without the $3.5 million gift to the unsecured creditors? Would the debtors have been obligated to take the bid that provided the greatest benefit to the estate, even if general unsecured creditors ultimately received less?

Courts understand that a number of non-financial factors can and do come into play when a debtor is evaluating competing offers. "Higher" does not necessarily equate with "better" where bids are concerned. Some of these non-financial factors are straightforward in how they benefit the debtor, such as closing risk,[71] litigation risk,[72] and simplicity,[73] and all have been recognized as such by courts. Other factors, such as the fact that the purchaser will employ more of the debtor's current employees, while of less intuitive benefit to the debtor's estate, can likely be justified by a need to maintain employee morale.[74] In a true liquidation context, however, it would be harder to claim that the *estate* is benefiting from the purchaser continuing to employ the debtor's employees. Finally, in bankruptcies of non-profits, continuation of the public

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[70] *Id.* at *8.
[71] *In re Bakalis*, 220 B.R. 525 (Bankr. E.D.N.Y. 1998).
[72] *In re Elcom Hotel & Spa, LLC and Elcom Condominium, LLC*, Nos. 13-10029 / 13-10031 (BKC-RAM) (Bankr. S.D. Fla.).
[73] *In re Scimeca Found., Inc.*, 497 B.R. 753 (Bankr. E.D. Pa. 2013).
[74] *In re WP Steel Venture LLC*, No. 12-11661 (KJC) (Bankr. D. Del.).

mission[75] has been approved as a ground for the debtor to choose a less remunerative bidder — after all, when a business has not been viewed strictly in economic terms since its inception, it is likely that a court is willing to take a broader non-economic view of highest and best.

D. ABI Commission Recommendations Regarding Sales Without a Plan

The Commission's Report notes the controversy that has arisen around structured dismissals. As the Report highlights, opponents of structured dismissals argue that such dismissals are not authorized by any provision of the Bankruptcy Code. Proponents of the practice argue that such dismissals are in fact authorized and have practical benefits. While both sides of the question agree that the Bankruptcy Code authorizes a court to issue a standard dismissal, and is silent as to what such a dismissal order can contain, both parties are also able to draw on statutory support for their positions.

Some commissioners were initially open to the use of structured dismissals in cases where there was no alternative available. However, other commissioners noted that the source of structured dismissals in their view is not a lack of alternatives but instead a desire by debtors or purchasers to affect a sale free and clear of liabilities (potentially with the benefits of releases or other benefits of a confirmation order) without having to comply with the requirements of the confirmation process. Ultimately, the Commission, while acknowledging certain benefits of a structured dismissal, recommended that the Bankruptcy Code be amended to restrict the practice. Many of the benefits of structured dismissals could be better addressed, in the Commission's view, by adopting the Report's recommendations with regard to 363x sales. Specifically, the proposed section 363x would incorporate many key creditor protections that are typically part of the confirmation process (namely, that a sale comply with applicable provisions of the

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[75] *In re New York City Opera, Inc.*, No. 13-13240 (SHL) (Bankr. S.D.N.Y.).

Bankruptcy Code, that it be proposed in good faith, that its costs be reasonable, that administrative creditors and tax claims be paid in full, and that sufficient notice be provided), while also allowing the sale order to include any needed releases or specified distributions to certain creditors.

VIII. What to do after the auction is over? (Reopening an auction)

Historically, courts have generally been wary of reopening an auction once the debtor has announced a successful bidder.[76] In doing so, the court must balance the integrity and finality of auctions with the best interests of all creditors. Given the importance attached to the finality of sale orders, courts will only reopen auctions before the sale closes under strict and limited circumstances.[77] For example, courts may allow a reopening of an auction if it can be shown there was a deprivation of due process for a key party in interest[78] or clear evidence of impropriety.[79]

Under certain circumstances, a bankruptcy court can also disapprove a proposed sale and reopen the bidding if "it has an awareness that there is another proposal in hand which, from the estate's point of view, is better or more acceptable."[80] As recently illustrated in *In re Allied*

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[76] *In re Reading Broad., Inc.*, 386 B.R. 562, 575 (Bankr. E.D. Pa. 2008) ("Courts have long concluded that the ability to achieve the highest price would be undermined if bankruptcy sales were not considered final at the conclusion of an auction, unless clear evidence of impropriety in the sale process has been demonstrated.").

[77] However, in the chapter 15 context, bankruptcy courts in the Second Circuit must conduct their own *de novo* review under section 363 of a sale approved by a foreign proceeding before approving a sale of U.S. assets. *See Krys v. Farnum Place, LLC (In re Fairfield Sentry Limited)*, 768 F.3d 239 (2d Cir. 2014). In *Krys,* following the approval by a British Virgin Islands court of a sale of assets (namely a claim against the Madoff estate) of a Madoff feeder fund, the value of the claim rose dramatically before the sale could be approved in the United States. Well aware of the intervening increase in value, the Second Circuit remanded the proposed sale of the assets in the U.S. for an independent review of the sale under section 363, fully *de novo*, (*i.e.*, not at the time of the originally approved BVI sale), in effect giving the sellers a second chance to realize a higher sale price.

[78] *Am. Plant Food Corp. v. United Agri Prods., Inc. (In re Farmland Indus., Inc.)*, 289 B.R. 122 (B.A.P. 8th Cir. 2003).

[79] *Reading Broad.*, 386 B.R. at 576 ("Typically, evidence justifying vacating a trustee's sale of assets will involve collusion between bidders, or between sellers and bidders, or some type of fraudulent behavior.").

[80] *In re Sunland, Inc.*, 507 B.R. 753 (Bankr. D.N.M. 2014) (quoting *In re Broadmoor Place Inv., L.P.*, 994 F.2d 744, 746 (10th Cir. 1993)).

System Holdings, Inc.,[81] the key determinant is whether the estate shares the viewpoint that a competing offer is more acceptable and beneficial to all creditors. If a debtor is on board with reopening the auction due to a significant post-auction offer, the court will defer to the debtor's judgment that reopening the auction is in the estate's best interests.

A. *In re Allied System Holdings, Inc.*

1. Background

The debtors conducted a two-day out-of-court auction to sell substantially all of their assets and declared a winning bid of $40.5 million in cash and a $64.5 million credit bid by an acquisition vehicle established by the first lien lenders. Shortly after the auction was over, however, the official committee of unsecured creditors objected to the winning bid and moved to reopen the auction to address a concern that the auction was not conducted in a fair and open manner. The committee also had an allegedly significantly higher and better offer: $135 million ($125 million in cash and $10 million in notes or cash). The debtors eventually acquiesced and joined the committee in seeking to reopen the auction.

2. Holding and Rationale

At the hearing, the debtors explained to the court that, given the higher and better offer submitted by the strategic bidder following the close of the auction, the debtors did not believe it was proper to move forward with the sale hearing and seek approval of the winning bid submitted at auction. Moreover, after receiving the subsequent bid, the special committee of the debtors' board of directors determined that it was in the debtors' best interest to reopen the auction. The first lien lenders who submitted the winning bid argued that allowing the auction to be reopened would threaten the integrity of the auction sale process.

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[81] No. 12-11564 (Bankr. D. Del. June 11, 2012).

At the telephonic hearing, the court framed the question as "pretty simple," and was simply "do I bow to the debtor's exercise of its business judgment . . . in this context to reopen the new auction to allow perhaps a greater value to the estate to accrue as a result of the auction being reopened?"[82] Ultimately, the court felt it was necessary to reopen the auction so that the debtors could fulfill their fiduciary duties and maximize value for the estate. The court explicitly stated that it would not reopen the auction solely on arguments from the committee and the opposing bidder, but the debtors' decision to join the committee ultimately led the court to its decision to reopen the auction.

3. Post-Decision Events and Observations

Allied Systems Holdings represents an unusual case where the court agreed to reopen an auction solely so that a creditor can find a better offer. The parties were correct in this instance and able to indeed find a better offer. However, reopening an auction solely to increase the benefit to the estate is a controversial practice.

B. Bad Faith Purchaser

Although the Bankruptcy Code does not specifically define "good faith purchaser" for purposes of section 363, courts have generally adopted the traditional equitable definition of good faith purchaser, *i.e.*, one who "purchases the assets for value, in good faith and without notice of adverse claims."[83] In general, the type of misconduct that would destroy a purchaser's good faith status typically involves some type of fraud or collusion, or otherwise takes advantage of other bidders.[84] When a party in interest believes such conduct can be shown through the

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[82] *In re Allied Sys. Holdings*, No. 12-11564, Sept. 9, 2013, Hr'g Tr. 25 (Bankr. D. Del.) [Dkt. No. 1795].
[83] *In re Gucci*, 126 F.3d 380, 390 (2d Cir. 1997); *In re Abbotts Dairies of Pennsylvania, Inc.*, 788 F.2d 143, 147 (3d Cir. 1986) ("Courts applying section 363(m) (and its predecessor, Fed. R. Bankr. P. 805) have, therefore, turned to traditional equitable principles, holding that the phrase encompasses one who purchases in 'good faith' and for 'value.'").
[84] *Abbotts Dairies*, 788 F.3d at 147; *In re Rock Indus. Mach. Corp.*, 572 F.2d 1195, 1198 (7th Cir. 1978) ("Typically, the misconduct that would destroy a purchaser's good faith status at a judicial sale involves fraud,

conduct of the debtor or purchaser, the party in interest may also assert common law fraud claims. However, as recently illustrated in *Alamo Group, LLC v. A&G Realty Partners, LLC (In re OSH 1 Liquidating Corp.)*,[85] success on such common law claims will require a satisfaction of the traditional common law fraud elements, including materiality.

C. *In re OSH 1 Liquidating Corp.*

1. Background

This adversary proceeding arose in connection with the marketing of lease designation rights by the debtors. Following a sale of substantially all of the debtors' assets, the remaining property in the estate included nine unexpired commercial leases. Defendant A&G acted as the debtors' real estate broker and assisted in selling the rights to the remaining leases. Ultimately, the plaintiffs and debtors entered into a designation rights agreement, which provided the plaintiffs with the right to accept or reject assumption of any of the remaining leases for a period of time.

One day prior to the hearing on the designation rights agreement, the defendant brokers informed the plaintiffs of a competing bid from two individuals. The plaintiffs entered into a non-disclosure agreement, reviewed the letter of intent, and increased their bid from approximately $315,000 to $1.2 million as a result of the letter of intent. The court approved the amended designation rights agreement thereafter.

Following court approval, plaintiffs initiated an adversary proceeding, alleging that the competing bid was a sham transaction, and that the competing bid was submitted entirely at the instruction of the defendant brokers in order to raise the plaintiffs' offer. Moreover, the plaintiffs

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collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders.").

[85] Adv. Pro. No. 14-50103 (Bankr. D. Del. May 12, 2015) (the "OSH Decision").

alleged that the defendant brokers intentionally misrepresented certain details about the competing proposal.

2. Holding and Rationale

The court examined the first element of common law fraud under Delaware law: a false representation of material fact made by the defendant. In order to be material, the allegedly false statement must have "a natural tendency to influence, or [be] capable of influencing, the decision of the decision-making body to which it was addressed."[86] In this case, the defendant brokers had allegedly told the plaintiffs that the competing bid was out of the blue and unsolicited. The plaintiffs alleged that, in reality, defendants had been in contact with the two individuals making the offer and instructed them to submit their higher bid. However, the court recognized that the original designation rights agreement did not prohibit competing bids. Taken as true, these facts did not support the inference that the defendants' misrepresentations were material to the plaintiffs' decision to place a second bid. That a counteroffer was solicited by the defendant brokers was not the type of information that has a "natural tendency" to alter the decision-making. According to the court, "whether the counteroffer was solicited or made 'out of the blue,' the outcome would have been the same: plaintiffs would have had to make a higher offer to get the lease designation rights."[87]

The court also found that there was not a viable fraud by omission claim. The plaintiffs failed to present sufficient evidence to show a deliberate concealment of material facts by the defendant brokers. The evidence failed to show that defendant brokers insisted on a non-disclosure agreement in order to prevent the plaintiffs from communicating with the competing

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[86] OSH Decision at 11.
[87] OSH Decision at 12.

bidders, nor was there evidence supporting the inference that the defendant brokers even knew about the alleged deficiencies in the competing bid.

3. Observations

OSH 1 Liquidating Corp. shows the difficulty that a buyer can face in challenging a sale (either directly or indirectly through a fraud claim) after the sale has been completed. It also raises an interesting question for future cases, given the allegedly surreptitious actions by the debtors or their agent: Should all auctions be fully open such that all parties share the same information? Granting all of the potential bidders the same information could potentially elevate these bad-faith concerns. However, companies in bankruptcy are already under extensive disclosure requirements — widespread disclosure of key information about the debtor's operations could ultimately harm the value of the going concern and diminish the value received at a sale by the estate.

D. ABI Commission Recommendations Relating to the Finality of Sale Orders

The Commission reviewed a number of cases[88] where courts confronted the issue of when to reopen an auction process or otherwise undo a sale order. While the Commission acknowledged that reopening the auction resulted in greater value for the estates (such as in *Allied Systems Holdings*), they also questioned if allowing such reopening to become routine would weaken the effectiveness of the original auction process. The Commission also noted that Rule 60(b) of the Federal Rules of Civil Procedure allows a court to relieve a party from the finality of an order only if the moving party can show "fraud, . . . misrepresentation, or other misconduct of an adverse party." Thus, the Report recommends that auctions be reopened, and

[88] *Contrarian Funds, LLC v. WestPoint Stevens, Inc. (In re WestPoint Stevens, Inc.)*, 333 B.R. 30 (S.D.N.Y. 2005) *rev'd* 600 F.3d 231 (2d Cir. 2010).

sale orders set aside, only when the moving party can show a procedural problem with the original auction or sale, or other similar extraordinary circumstances.

IX. Who do you sue after the sale? (Free and clear)

As discussed above, section 363(f) authorizes the debtor to sell estate assets "free and clear of any interest in such property of an entity other than the estate." Practitioners and judges, however, continue to struggle over the nature of this provision. While clearly section 363(f) allows the sale of estate assets free and clear of liens, other "interests" in property, such as easements and other restrictions that run with the land, were likely not intended to be included within section 363(f)'s free and clear language. Additionally, sale orders have increasingly included language relieving the purchaser from claims based on tort or similar liabilities related to the assets, with some noted exceptions (such as certain environmental clean-up requirements,[89] or certain labor-related pension claims[90]). Finally, purchasers can choose to assume certain liabilities of the debtors, such as collective bargaining agreements,[91] leases,[92] or trade debt.

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[89] *See Ninth Ave. Remedial Group v. Allis-Chalmers Corp.*, 974 F. Supp. 684 (N.D. Ind. 1997) (holding that section 9607(e) of CERCLA (the federal environmental liability clean-up law) prohibits private parties from determining liability through contract, including 363 sale orders — though parties remain free to indemnify each other for future claims).

[90] *See Einhorn v. M.L. Ruberton Const. Co.*, 632 F.3d 89, 99 (3d Cir. 2011) (purchaser may be liable under ERISA for prepetition pension obligations if purchaser had notice of the liabilities prior to the sale, and there is "sufficient evidence of continuity of operations between the buyer and seller"); *Chicago Truck Drivers, Helper & Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc.*, 59 F.3d 48 (7th Cir. 1995) (same). *But see*, *In re Ormet Corp.*, No. 13-10334, 2014 Bankr. Lexis 3071, at *7 (Bankr. D. Del. July 17, 2014) (approving a sale of assets free and clear of prepetition pension plan liability and noting that *Einhorn* and *Chicago Truck Drivers* did not involve a sale of assets under section 363(f)).

[91] Note though that any "choice" a debtor or purchaser may have with regard to collective bargaining agreements is subject to section 1113. *See In re Bruno's Supermarkets, LLC*, No. 09-00634, 2009 Bankr. LEXIS 1366 (Bankr. N.D. Ala. April 27, 2009) (upholding successorship clauses in collective bargaining agreement, and rejecting debtors' attempts to modify the provision in advance of a sale under section 1113) (citing *In re American Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984)).

[92] A bidder can agree to pay cure costs such that the debtor can assume and assign the favorable lease to the successful bidder. *See In re Elcom Hotel & Spa, LCC and Elcom Condominium, LLC*, Case Nos. 13-1029/13-10031 (Bankr. S.D. Fla.); *In re RadioShack Corp.*, No. 15-10197 (Bankr. D. Del.).

The best known of such sale orders was entered by Judge Gerber, following the historic sale of GM, in the summer of 2009.[93]

A. *In re Motors Liquidation*

The recent decision in *In re Motors Liquidation*, while discussed extensively above in the context of its effect on notice requirements for 363 sales, also shows the breadth of section 363(f)'s free and clear language, while still being subject to the constitutional notice limitations discussed above.

While the dramatic arc of the automotive bankruptcies in 2009 is beyond the scope of this article, a discussion of Judge Gerber's opinion regarding section 363(f)'s free and clear language is instructive. Accident claimants of the Old GM challenged the proposed sale order, which stated that while New GM would assume liability for all *future* personal injury product liability claims related to the vehicles, whenever manufactured, current product liability claimants claim's against Old GM would *not* be assumed, even for personal injury claims. The existing personal injury claimants (the "Accident Claimants") challenged this provision of the sale order, arguing that the Bankruptcy Code did not allow sales of the debtor's property free of a certain kind of claim.

Judge Gerber found the textual arguments provided by the Accident Claimants (comparing 363 to 1141(c)) to be unpersuasive, and ultimately found that the text of the code did "not support or foreclose the possibility that an 'interest in property' covers a right that exists against a new party solely by reason of a transfer of property to that party."[94] Judge Gerber thus

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[93] *In re General Motors Corp.*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009) (Gerber, J.), stay pending appeal denied, 2009 WL 2033079 (S.D.N.Y. Jul. 9, 2009) (Kaplan, J.) (the "Stay Opinion"), *appeal dismissed* and *aff'd sub nom Campbell v. General Motors Corp.*, 428 B.R. 43 (S.D.N.Y. 2010) (Buchwald, J.) and *Parker v. General Motors Corp.*, 430 B.R. 65 (S.D.N.Y. 2010) (Sweet, J.), *appeal dismissed*, No. 10–4882–bk (2d Cir. July 28, 2011) (per curium, Jacobs, CJ, and Hall and Carney, JJ.), *cert. denied*, 132 S. Ct. 1023 (2012).
[94] *General Motors Corp.*, 407 B.R. at 504.

relied upon what was well-established Second Circuit precedent (though not well established nationally) that 363(f)'s free and clear language extended to successor liability, including liability for tort claims. Specifically, just weeks before, Judge Gonzales had approved a similar sale order in the *Chrysler* bankruptcy.[95] Moreover, Judge Gonzales's decision in *Chrysler* had been affirmed in judgment (though not necessarily in reasoning) by the Second Circuit. Faced with what was, in his view, binding precedent, Judge Gerber approved the sale order's free and clear provisions.

However, as discussed extensively above, following the widespread publication of the ignition switch defects and the associated recall, nearly 60 class action lawsuits have been brought against New GM on the basis of the defects. With the significant but limited exception of claimants who were able to show constitutionally deficient notice (and, more importantly, prejudice from such deficient notice), the sale order has survived challenges, notwithstanding its broad scope. Only those alleging economic loss were prejudiced by the fact that they were unable to argue at the sale hearing that the proposed sale order was overly broad and that the sale order should clarify that parties were allowed to assert claims involving Old GM vehicles as long as such claims were based solely on New GM conduct. All other claims could, even years removed from the GM bankruptcy and sale order, only look to Old GM for satisfaction.

B. ABI Commission Recommendations Regarding Sales "Free and Clear"

The Commission, while concerned with the notice and consent issues discussed throughout this article, nonetheless also agreed that the ability of a debtor to transfer clean title to a purchaser (to the extent such a transfer could be accomplished under the U.S. Constitution) could be of significant value to the estate. With the caveat that the Commission's recommendations should only apply to sales that comply with the due process and notice

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[95] *In re Chrysler LLC*, 405 B.R. 84, 111 (Bankr. S.D.N.Y. 2009).

requirements of its 363x sales proposal, the Report recommends a number of clarifications to the scope of 363(f) so that in future cases parties could more clearly understand which liabilities were and were not transferred with the sale. Specifically, the Commission found that a debtor should be able to sell a property free of all liens, interests, and claims, including civil rights liabilities, as well as successor liability in tort and contract, within constitutional limits. However, easements, covenants, usufructs, equitable servitudes that run with the land, environmental liability, federal labor law successor liability, and competing ownership interests (except as allowed under 363(h) and (i)) should not fall within section 363(f)'s definition of free and clear. Finally, the Report also recommends that 363(f) be further clarified to ensure that a debtor does not sell assets in a manner that would frustrate the federal or a state government exercising its police power in a manner that would similarly exempt that government from complying with the automatic stay.

X. Where do we go from here? (Concluding considerations)

Ultimately, underlying all of the issues discussed throughout this article are three questions worthy of rigorous debate and analysis by the entire restructuring community: (a) is there a genuine need for section 363 reform; (b) if so, does the Commission strike an appropriate balance between the various competing interests discussed throughout this article; and (c) what alternatives to the Report's recommendations, including the status quo, are worthy of consideration? A thorough analysis of these issues is likely to strengthen the bankruptcy process, regardless of the actual outcome.