ALERTS

Bankruptcy Court Dismisses Collusive Bidding Claim

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A credit-bidding lender ("Lender") acquired a debtor's assets "in 'good faith' and 'without collusion,' the purchase price 'was not controlled by any agreement among potential bidders,' and [Lender] had not 'engaged in any conduct that would cause or permit the Purchase Agreement to be avoided or costs and damages to be imposed under section 363(n) of the Bankruptcy Code,'" held the U.S. Bankruptcy Court for the Southern District of New York on Sept. 10, 2019. *In re Waypoint Leasing Holdings, Ltd.*, 2019 WL 4273889, *11 (Bankr. S.D.N.Y. Sept. 10, 2019). The disappointed stalking horse bidder, M, "blame[d] [its] loss of the sale and/or a $19.5 million break-up fee" plus an expense reimbursement claim (up to $3 million) on the defendant acquiror, L. "[I]n its capacity as assignee" of the Chapter 11 debtors and "in its own right," M had sued L for damages. *Id.* at *1. M alleged that L "had colluded with [Lender] to control the sale price of the … assets in violation of" Bankruptcy Code ("Code") § 363(n). *Id.* at *5.

Relevance

Code § 363(n) presumes that collusive bidding is, per se, bad faith. In relevant part, it reads as follows: "if the sale price was controlled by an agreement among potential bidders," the "trustee may avoid" the sale or, alternatively, "recover" the difference between the price paid and the "value of the property sold" from any party to such agreement. The colluding parties may also be held liable for "costs, attorneys' fees, or expenses" and, if "willful disregard of this subsection" is found, punitive damages.

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Facts

Marketing; Non-Disclosure. The debtor marketed the sale of its helicopter assets. L signed a non-disclosure agreement enabling it to acquire confidential information relevant to any proposed sale. Under that agreement, L could use confidential information only to evaluate the assets and participate in discussions with the debtor, but could not contact any creditor or subsidiary of the company except in the ordinary course of business. L was also barred from disclosing or referring to a potential transaction with the debtor or to confidential information obtained from the debtor.

Bidding Procedure. M agreed to buy the debtor's assets as a stalking horse bidder. The debtor later obtained from the court an appropriate bidding procedures order that set up a process for third-party bidding and secured lender credit bidding. M would be entitled to a break-up fee of $19.5 million plus up to a $3-million expense reimbursement claim unless "a transaction was effected through a credit bid." *Id.* at *2. Also, if Lender "made a credit bid for the [assets] in the full amount of its claim, [M] could not submit a matching bid." *Id.*

The bidding procedures order further modified the "no contact" provisions in the non-disclosure agreements signed by Lender and L. "The secured [creditors] could engage in discussions and negotiations with an entity to manage the assets upon the consummation of a successful credit bid … and were released from any restriction on 'engaging in discussions or negotiations' under their agreements with the [debtor]." *Id.*

Bidding. No third parties submitted a bid, leaving only M and Lender as potential purchasers. Lender "submitted a credit bid for the [assets] in the amount of 100% of its claim." At the sale hearing, Lender disclosed that it had discussed with L "a subsequent transaction pursuant to which the [assets] would be recapitalized and sold to [L]." *Id.* at *3. Lender also testified that it had negotiated with M "as the … proposed stalking horse bidder … [stating] that if [M] wanted to acquire the [assets], it 'needed to pay par plus accrued interest.'" *Id.* According to the court, though, Lender was "not a helicopter leasing company [but] intended to sell the … [assets] at some point in the future." *Id.* It had "preliminary discussions with potential servicers," but never disclosed confidential information about the assets and "had no agreement to sell the assets." *Id.*

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Issues at Sale Hearing. M's counsel argued at the sale hearing that Lender "had violated the confidentiality and 'no-contact' provisions of its own non-disclosure agreement … and had entered into a collusive bidding agreement with [L]." *Id.* Because it had no facts to support its assertions, it suggested that the court allow it time for discovery, but the court rejected that request. Thus, the possible violation of the non-disclosure agreement and collusive bidding had been raised by M when it objected to the sale of the assets to Lender.

Court Ruling at End of Sale Hearing. The court ruled at the end of the sale hearing that Lender had been the credit bidder for the assets, meaning that M was not entitled to a break-up fee based on Lender's successful credit bid. Nor was there any evidence, found the court, that Lender "had shared any confidential information with any servicers …." *Id.* at *4. The court further discounted Lender's possible "technical violation" of the non-disclosure agreement when Lender "had discussed the possibility of a future sale" of the assets to L. Also, Lender had not acted in bad faith when it started to look for a subsequent purchaser, primarily because Lender intended "to liquidate its collateral and get paid back," not wanting to "incur the costs of insuring the aircraft and paying a servicer." *Id.*

The court later signed the asset sale order, finding that Lender had "complied with" the bidding procedures, "was the successful bidder," was a "good faith purchaser" and that neither the debtor nor Lender had "engaged in any conduct that would cause or permit the Purchase Agreement to be avoided or costs and damages to be imposed under section 363(n) of the … Code." The amount of Lender's credit bid totaled $98.4 million, "the highest and best value" for the assets. The sale order also preserved any asserted claim by M for "damages flowing from violations of the Bidding Procedures or Bidding Procedures Order 'arising from intentional misconduct.'" *Id.* at *4-5.

M's Later Claims

M asserted three claims against L in a later suit. First, as assignee of the debtor, M asserted that L had breached the confidentiality and "no-contact provisions" of the non-disclosure agreement. M's second claim, asserted in its own right, asserted that L had "tortiously interfered with its business relationship" with the debtor. Finally, M asserted, both in its own right and as assignee of the debtor, that L had "colluded with [Lender] to

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control the sale price of" the assets in violation of Code § 363(n). The court easily disposed of the first two claims asserted by M.

No Damages for Asserted Confidentiality Breach. Assuming that L had breached the non-disclosure agreement by contacting Lender, M "failed to allege how those contacts damaged" the debtor. M speculated "that the collusive bidding arrangement between [Lender] and [L] induced Lender to make a credit bid it would not have otherwise made and thus deprived" the debtor of "obtaining potential competing cash bids" for the assets. According to the court, M's claim of asserted harm to the debtor "defies common sense." *Id.* at *7. "To suggest that [Lender] would not have made a credit bid but for [L's] prompting to prevent a sale at a depressed price ... ignores the entire purpose of the right to credit bid ...." *Id.* Nor did M allege that its cash bid for the assets "was higher, a critical piece of information in determining if the Debtor was damaged, or that [M] intended to pay anything more which, in any event, seemed unlikely." *Id.* According to undisputed testimony, M "could have purchased [Lender's] claim for par plus interest .... Had it done so, it could have made its own credit bid." *Id.* In any event, Lender "outbid [M] by roughly $13 million to prevent a sale to M at a depressed price ...." *Id.* Moreover, no third party could have stepped in with a higher offer because "the deadline for third-party bids had expired before [Lender] made its credit bid ...." A "third party would [still] have had to bid at least $121 million" for the assets in order for its bid to top "[Lender's] credit bid." *Id.*, at * 7.

No Tortious Interference. The court similarly rejected M's tortious interference claim. L was admittedly "engaged in the business of leasing aircraft ... and ... was [M's] competitor. If [L] induced [Lender] to sell it the [assets] for its own economic benefit it did not use wrongful means." *Id.* at *9. L never engaged in "physical violence, fraud or misrepresentation, civil suits [or] criminal prosecutions." *Id.* The claim thus failed as a matter of law.

No Collusive Bidding. The court discussed M's collusive bidding claim, quoting the operative language of Code § 363(n): was "the sale price ... controlled by an agreement among potential bidders?" According to the court, "'control' means more than causing 'an incidental or unintended impact on the price; it implies an intention or objective to influence the price.'" *Id.* at *9, quoting *In re New York Trap Rock Corp.*, 42 F.3d 747, 752 (2d Cir. 1994). Further, said the court, "prohibited collusive agreements are secret agreements that have not been disclosed to the court." *Id.*, citing *In*

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re Colony Hill Assocs., 111 F.3d 269, 277 (2d Cir. 1997). Also, Code § 363(n) "only grants the right to bring a claim to a trustee or debtor in possession," but "an unsuccessful bidder may have standing to challenge the actions of a successful bidder that destroyed the 'intrinsic fairness' of the sale transaction so that it was not a good faith purchaser." *Id.*, citing *Colony Hill*, 111 F.3d at 274.

First, M lacked "standing to assert a claim" under § 363(n) "as assignee" of the debtor. *Id.* at *10. The debtor never assigned any rights under § 363(n), and M never even alleged that the debtor was "damaged by the alleged collusion." "Put simply, [Lender] outbid [M], the only other bidder." *Id.* at *10.

Nor could M challenge the "intrinsic fairness" of the sale in its own right. During an evidentiary hearing on the sale motion, M not only objected but was also heard by the court. At the end of the hearing, the court found that the debtor had "conducted a fair and open sale process"; that it was "non-collusive, properly noticed," and gave any other entity "a full, fair and reasonable opportunity … to make" a purchase offer. *Id.*, at * 10. In the sale order, the court also found that the parties had negotiated and agreed in good faith, "without collusion, and from arms' length bargaining positions"; Lender had been a "good faith purchaser "and had "complied with the Bidding Procedures Order." Finally, the court found that the purchase price had not been "controlled by any agreement among potential bidders"; neither the debtor nor Lender had "engaged in any conduct that would cause or permit the Purchase Agreement to be avoided or costs and damages to be imposed under" Code § 363. Finally, most important, M never appealed from the sale order. *Id.*

M's challenge to the "intrinsic fairness" of the sale repeated the same allegations it made at the earlier sale hearing, said the court. It was thus "an impermissible collateral attack on" the sale order and was barred "by the doctrine of collateral estoppel." *Id.* "If [Lender] did not improperly collude with [L], [L] did not improperly collude with [Lender]." *Accord*, *In re Farmland Indus., Inc.*, 408 B.R. 497 (B.A.P. 8th Cir. 2009), *aff'd on other grounds*, 639 F.3d 402 (8th Cir. 2011) (affirmed dismissal of alleged misconduct claims on collateral estoppel ground, among others; objecting party had opposed prior sale order but lost and never appealed; misconduct issues were the same as those that had already been litigated and determined by bankruptcy court in prior orders).

As the court stressed in *Waypoint*, "[t]o grant relief to [M] under section § 363(n), the Court would have to conclude, contrary to its prior findings,

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that the sale was unfair, the purchase price was controlled by an agreement between potential bidders and [Lender] acted in bad faith." *Id.* at *11. The court here had previously "overruled [M's] objections and found that [Lender] was a good faith purchaser that did not impermissibly collude with [L]." Although M lost, it "never appealed." Because M raised "the same collusion issues that were rejected by the Court and memorialized in" the sale order, the court dismissed M's "claims asserted as assignee and in its own right." *Id.* at *12.

Comments

1. *Waypoint* shows that Code § 363(n) is intended to block collusive agreements meant to deprive the debtor of the full market value of its assets, enabling the colluding parties to divide the benefit of an improper bargain. Essentially, § 363(n) applies when one bidder pays another bidder to drop out of the bidding process. At the very least, the section ordinarily enables the estate to recover the difference between the true value of the assets and its depressed purchase price.

2. M had its chance to make a case of collusion at the earlier sale hearing, but failed to do so. It took no discovery, had no supporting facts and failed to appeal from the sale order. The lesson here: a party making serious allegations of misconduct had better be able to prove the facts at trial, even when the court accelerates the process. *See New York Trap Rock*, 42 F.3d at 754 (discovery appropriate to ascertain why potential bidder dropped out of bidding).

3. Code § 363(n) applies to both public auctions and private sales of the debtor's property. *Ramsay v. Vogel*, 970 F. 2d 471 (8th Cir. 1992).

4. As the court in *Waypoint* noted, only the "trustee or debtor-in-possession" has "the right to bring a claim" under Code § 363(n). 2019 WL Y273889 at *9 n. 9, quoting the language of the Code: "The trustee may avoid ... or may recover ...." This is consistent with the Supreme court's holding in *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000) (only trustee has standing under § 506(c) to surcharge lender's collateral; "plain language" of Code). And, of course, a Chapter 11 debtor-in-possession has "the rights ... and powers" and must "perform all the functions and duties ... of a trustee." 11 U.S.C. § 1107(a).

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5. The bankruptcy court in *Waypoint* had jurisdiction over this dispute between third parties because the asserted claims arose out of the sale order and under Code § 363(n). 28 U.S.C. § 1334(b). M had also "consented to the entry of final … judgments by" the court and alleged that L had "consented" to the court's "exclusive jurisdiction … for any" actions "arising out of or relating to" the non-disclosure agreement it had signed. *Waypoint*, 2019 WL at *6.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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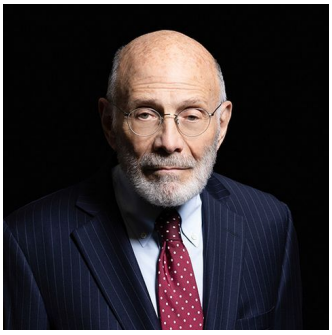

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