



THE AMERICAN LAW INSTITUTE

Young Scholars Medal Conference
New York, NY, April 4, 2017

Panel 3: Auctions (363 etc.)

Moderator: James P. Seery Jr., River Birch Capital

Panelists: Stephen Lubben, Seton Hall University & New York Times Dealbook; Christopher Sontchi, Bankruptcy Judge, Delaware; Jeffrey Gordon, Columbia University; Barry Adler, New York University; Elizabeth Stong, Bankruptcy Judge EDNY.

1. Anatomy of Corporate Transfers Outside of Bankruptcy

a. Commencing the Process

i. Decision to transfer

1. Spin Transactions

a. *See Liberty Media Corp. v. The Bank of New York Mellon Trust Co.*, C.A. No. 5702-VCL, 2011 WL 1632333 (Del. Ch. Apr. 29, 2011) (The Delaware Chancery Court set out a three-part test to determine when a series of spin-off transactions should be aggregated for the purpose of determining whether a sale of “substantially all assets” has occurred).

2. Sale of all or substantially all assets of a division

a. Under Section 271 of the Delaware General Corporation Law, the board of directors of a Delaware Corporation must have the approval of its stockholders to sell “all or substantially all of its property and assets, including goodwill and its corporate franchises.” In *Hollinger Inc. v. Hollinger Int’l, Inc.*, (Del. Ch. July 29, 2004), the Delaware Chancery Court denied Hollinger Inc.’s request for a preliminary injunction and rejected its contention that stockholder approval is required for the sale of The Daily Telegraph newspaper because the Telegraph constitutes “substantially all” of Hollinger International’s assets within the meaning of Section 271. The court explained that if the remaining portion of a business constitutes a substantial, viable, ongoing component of the corporation, the sale is not subject to Section 271, and it rejected the notion that “substantially all” should be interpreted to mean “approximately half” for purposes of Section 271.

3. Putting the Company up for sale

a. In *Lyondell Chemical Company v. Ryan*, Del. Supr., ___ A.2d ___, No. 401, 2008, Berger, J. (Mar. 25, 2009), the Delaware Supreme Court rejected the notion that there are “legally

prescribed steps that directors must follow” in making reasoned decisions as to how best to satisfy the duty of obtaining the best price for stockholders in a sale of the company. Moreover, the Court held that in the context of a post-transaction damages lawsuit against directors of a target corporation whose charter contained an exculpatory provision relating to directors’ fiduciary duties, as permitted by section 102(b)(7) of the Delaware General Corporation Law, the correct inquiry regarding the duty of loyalty is not “whether disinterested, independent directors did everything that they (arguably) should have done to obtain the best sale price,” but rather “whether those directors utterly failed to attempt to obtain the best sale price.”

4. Board Duties and Oversight – Care and Loyalty
5. Retention of bankers – Contrast large corporate cases with sales by SMEs
 - a. Transfer process – auction vs. private sale
 - i. Maximizing value
 - b. Fairness
 - c. Solvency
 - i. As noted above, the *Lyondell* decision in 2009 rejected the notion that there are “legally prescribed steps that directors must follow” in making reasoned decisions as to how best to satisfy the duty of obtaining the best price for stockholders in a sale of the company. But while the Delaware Supreme Court granted summary judgment in favor of the directors against a shareholder suit alleging that the company was not properly shopped, the directors still face post-bankruptcy risk. In *Weisfelner v. Hoffman (In re Lyondell Chemical Co., et al.)*, 2016 U.S. Dist. LEXIS 98057 (S.D.N.Y. 2016), Judge Cote revived an actual fraud fraudulent conveyance case holding that if the CEO led the company and many aspects of the sale process, his intent may be imputed to the company.
 - ii. Contrast the 2016 S.D.N.Y. *Lyondell* decision with 2017 S.D.N.Y. decision in *In re Tribune Company Fraudulent Conveyance Litigation*, 2017 WL 82391 (S.D.N.Y. Jan. 6, 2017). After the Second Circuit had previously shot down the litigation trustee’s constructive fraudulent conveyance claims on safe harbor grounds, the trustee continued to pursue his actual fraud theories. Judge Sullivan in the Southern District of New York dismissed with prejudice the

intentional fraudulent conveyance claim seeking \$8 billion that certain Tribune public shareholders received as part of the LBO that took place before the company's bankruptcy. Interestingly, Judge Sullivan arguably applied a different legal standard and clearly reached a different conclusion than *Lyondell* District Court which overturned the *Lyondell* Bankruptcy Court. Judge Sullivan applied the "control" test articulated by the *Lyondell* Bankruptcy Court, because the test "appropriately accounts for the distinct roles played by directors and officers under corporate law, while also factoring in the power certain officers and other actors may exercise over the corporation's decision to consummate a transaction." *Id.* at *6. Judge Sullivan also contrasted the case with *Lyondell* on a factual basis contrasting the Tribune independent board and solvency and fairness opinions with *Lyondell* where the "board allegedly plunged headlong into an LBO at the urging of its CEO, notwithstanding the board's failure to obtain a solvency opinion or obtain meaningful analysis from an independent advisor concerning the transferor corporation's ability to repay its debts." *Id.* at *9. Accordingly, the court held that because Tribune's corporate officers and potentially conflicted directors lacked sufficient control over the independent special committee's decision-making process, and that committee controlled the decision to approve the LBO, the intent of the potentially conflicted officers and directors could not be imputed to the company.

6. Legal analysis

- a. Transfer restrictions – contracts, licenses, etc.
- b. Management, labor and pension issues
- c. Financing
 - i. Credit agreement and indenture issues
 1. In *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, the Second Circuit overturned the district court's finding that a redemption premium under the governing indentures need not be paid. 691 F.2d 1039, 1053 (2d Cir. 1982). In this case, the indentures contained clauses permitting redemption by the borrower prior to the maturity date for payment of a fixed redemption price and

clauses allowing acceleration as a non-exclusive remedy in the case of a default. See id. at 1042-43. The Second Circuit held that the redemption premium must be paid, because “[t]he acceleration provisions of the indentures are explicitly permissive and not exclusive of other remedies.” Id. at 1053.

2. In another recent case, *Wilmington Savings Fund Society, FSB v. Cash America International, Inc.*, Case No. 15-cv-5027 (JMF), 2016 WL 5092594 (S.D.N.Y. Sept. 19, 2016), the Court adopted a more expansive interpretation of this exception based on *Sharon Steel*. Specifically, the Court held that noteholders were permitted to recover the make-whole following any event of default that resulted from a voluntary breach by the issuer even in the absence of an intent to evade the make-whole. Relying on the Second Circuit’s *Sharon Steel* decision, the Court held that because the Indenture did not mandate acceleration as the exclusive remedy, and the default was not due to bankruptcy, but rather Cash America’s “voluntary actions,” the Noteholders could seek specific performance of the redemption provisions of the Indenture, including the payment of the make-whole premium.
3. In addition to noting that the indenture in *Sharon Steel* contained the same type of optional prepayment provision, the Court concluded that because the Indenture, in effect, provided Cash America with the option to prepay in advance in order to avoid the breach, Cash America’s voluntary breach gave rise to the Noteholders’ right to enforce prepayment. Enforcing the prepayment provision, the Court concluded, led to the more equitable result because it prevented Cash America from placing itself in a better position by breaching the Indenture and gave effect to the bargained-for agreement among the parties.

- d. Governmental approvals
 - i. HSR
 - 1. Hart-Scott-Rodino Antitrust Improvements Act of 1976 – 15 U.S.C. § 18a
 - 2. Thresholds:

	ORIGINAL THRESHOLDS	ADJUSTED THRESHOLDS
Size of Transaction ¹	\$50 million	\$80.8 million
	\$200 million	\$323 million
Size of Persons ²	\$10 million	\$16.2 million
	\$100 million	\$161.5 million
Notification Thresholds ³	\$50 million	\$80.8 million
	\$100 million	\$161.5 million
	\$500 million	\$807.5 million
	25% of stock valued at \$1 billion	\$1,615.0 million
	50% of stock valued over \$50 million	50% over \$80.8 million

- ii. Licensing
 - iii. CFIUS
 - 1. CFIUS is an inter-agency committee authorized to review transactions that could result in control of a U.S. business by a foreign person in order to determine the effect of such transactions on the national security of the United States. CFIUS operates pursuant to section 721 of the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 2007 (section 721) and as implemented by Executive Order 11858, as amended, and regulations at 31 C.F.R. Part 800.
- b. Completing the transfer
 - i. Negotiating the agreement
 - 1. Indemnities, escrows, insurance
 - 2. Go-shop, no-shop
 - a. *See In re Del Monte Foods Co. Shareholders Litigation*, 25 A.3d 813 (Del. Ch. 2011) (questioning the terms of a go-shop period whereby no other suitors stepped forward, and noting that Barclays – the bank advising Del Monte – had “secretly and selfishly manipulated the sale process.”)
 - 3. Break-up fees
 - a. *See, e.g., Williams Companies, Inc. v. Energy Transfer Equity, L.P.*, 2016 WL 3576682 (Del. Ch. June 24, 2016) (Ruling that the company can back out of a \$33 billion deal without break-up fee. Williams indicated that it would enforce its rights

under the terms of the agreement if Energy Transfer attempted to terminate the agreement).

- b. Similarly, in a relatively consistent set of rulings, Delaware courts have upheld breakup fees falling within the statistically-supported 3% to 4% range (e.g., 3% in Cogent, 3.3% in MONY, 3.75% in Toys “R” Us and 4.3% in Topps). On a few of the rare occasions when a Delaware judge looked at a fee outside that range, the court upheld a 4.4% fee describing it as “near the upper end of a ‘conventionally accepted’ range” (Answers) and criticized a 6.3% fee (Cyprus Amax) noting that it “seems to stretch the definition of range of reasonableness ... beyond its breaking point.” *See Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999)(*dicta*; decision primarily focused on no-talk and determining, at preliminary stage, that “the decision not to negotiate ... must be an informed one” top satisfy a board’s duty of care).

4. Earn-outs

ii. Board approval

iii. Shareholder approval

1. *See, e.g., Corwin v. KKR Fin Holdings LLC*, 125 A.3d 304 (holding that that transactions approved by a fully informed, un-coerced stockholder vote will be reviewed under the business judgment rule when not subject to the entire fairness standard of review.)

c. Disputes with Shareholders

i. Challenges to the process

ii. Appraisal rights

1. *In re Appraisal of Dell Inc.*, 2016 WL 3186538 (Del. Ch. May 31, 2016) (holding in an appraisal proceeding that the fair value of Dell Inc. was 28% higher than the price paid for it – and approved by a majority of unaffiliated shares. The Court concluded that there was a significant valuation gap between the long-term value of Dell and the market’s short-term focus).

2. **Genesis of a Corporate Transfer In a Bankruptcy Case**

- a. Involvement of the Court -- At what stage of a case should a Debtor be permitted to sell all or substantially all of its assets free and clear?

i. First-day involvement

1. Pre-pack with auction

- a. *See, e.g., DS Liquidation L.P.*, Case No. 11-12935 (Bankr. D. Del. Sept. 22, 2011); *Texas Rangers Baseball Partners*, Case No. 10-43400 (Bankr. N.D. Tex. Aug. 5, 2010).

2. Early in the case subject to a pre-petition PSA

3. DIP with milestones, including auction

- a. *See, e.g., In re Aeropostale, Inc.*, Case No. 16-11275 (SHL) (Bankr. S.D.N.Y. Aug. 12, 2016) (auction within 141 days after commencement, among other milestones).
 - b. *See, e.g., In re American Apparel, LLC*, Case No. 16-12551 (BLS) (Bankr. D. Del. Dec. 12, 2016) (auction within 65 days of petition date, among other milestones).
 - 4. Local rule restrictions
 - a. *S.D.N.Y. Local Rule 4001-2; Delaware Local Rule 4001-2*
 - ii. Later in the case sales
 - 1. Sales pursuant to defaults under DIP
 - a. Milestones
 - b. “True” covenant or payment default
 - i. Lift stay vs. 363
 - 2. Debtor determination to sell
- b. Protections in the process
 - i. Section 363 vs. 1129 vs. Chapter 7
 - 1. Due Process Concerns – Free and Clear
 - a. *Elliott v. Gen. Motors LLC*, 829 F.3d 135 (2d. Cir. 2016) (finding an exception to the “free and clear” language of section 363(f) where adequate notice of the sale order is not provided).
 - 2. Court consideration of statutory protections
 - a. Process
 - i. The short time between a proposed sale and authorization can leave a creditor little time to formulate a meaningful objection to counter the debtor’s extensively prepared argument for the sale’s dire need. *See In re Bombay Co.*, No. 07-44084-RFN-11, 2007 WL 2826071, at *4 (Bankr. N.D. Tex. Sept. 26, 2007) (noting that even though there were some objectors, the court was not satisfied that all potential objectors had the opportunity to voice their objections); *In re Naron & Wagner, Chartered*, 88 B.R. 85, 89 (Bankr. D. Md. 1988) (holding a second round of notice statements as adequately notifying creditors in lieu of chapter 11 organization disclosure).
 - ii. Constituents
 - ii. How should a Debtor be able to complete “free and clear” sales?
 - 1. Public Auctions vs. private sales
 - a. *See, e.g., Simantob v. Claims Prosecutor, LLC (In re Lahijani)*, 325 B.R. 282, 288-89 (B.A.P. 9th Cir. 2005) (“The court’s obligation in § 363(b) sales is to assure that optimal value is realized by the estate under the circumstances. . . .

The price achieved by an auction is ordinarily assumed to approximate market value when there is competition by an appropriate number of bidders. When competition is constrained, however, the price is less likely to be reliable and should be examined more carefully.”); *In re Angelika Films 57th, Inc.*, No. 97 Civ. 2239 (MBM) (S.D.N.Y. May 29, 1997) (“[T]o maximize the value of the lease, the sale was subject to an auction sale . . .”). *See also* Fed. R. Bankr. P. 6004(f)(1). Rule 6004 also authorizes private sales but debtors frequently rely on public auctions to protect the company from arguments it did not maximize value for the creditors.

2. Bid Protections

- a. Overbid and break-up fee protections
 - i. *See, e.g., In re RadioShack Corporation*, Case No. 15-10197 (BLS) (Bankr. D. Del. Mar. 9, 2015) (overbid protection amount was to be announced at auction, breakup fee of \$6 million)
- b. No shop
- c. Purchase agreement terms to limit or enhance competition
 - i. Valuing non-conforming provisions

3. Credit bidding

- a. “For Cause” limitations under § 363(k)
 - i. *RadLax Gateway Hotel LLC v. Amalgamated Bank*, 566 U.S. 639 (2012) (holding that a debtor may not confirm a chapter 11 cramdown plan that provides for the sale of collateral free and clear of existing liens, but does not permit a secured creditor to credit-bid at the sale.)
 - ii. *In re The Free Lance-Star Publishing Co. of Fredericksburg, VA*, 512 B.R. 798 (Bankr. E.D. Va. 2014) (holding that creditor did not have right to credit bid on assets that did not secure its allowed claim, and cause existed to limit creditor’s right to credit bid at auction sale of debtors’ assets, even as to assets in which creditor had valid security interest, based on creditor’s over-zealous loan-to-own strategy).
 - iii. *In re Fisker Automotive Holdings, Inc.*, 510 B.R. 55 (Bankr. D. Del. 2014) (creditor that purchased DOE’s secured \$168 million loan to bankrupt electric car company for \$25 million would not be allowed to credit bid the entire \$168 million claim at sale of car company’s assets).
 - iv. Disputed assets and bid chilling

1. Is bid chilling reason enough to limit?
 - a. *See, e.g., In re Stroud Ford Inc.*, 163 B.R. 730, 733-34 (Bankr. M.D. Pa. 1993) (finding that payment from a potential buyer to a competing bidder in exchange for withdrawal of an objection to the bid was collusive – and enough to chill bidding - even though the payment was disclosed).
 2. Setting a public reserve price
 - b. Valuing unencumbered assets
 - iii. Highest and Best Determination
 1. *In re Bakalis*, 220 B.R. 525 (Bankr. E.D.N.Y. 1998) (holding that (1) court would accept Chapter 7 trustee’s recommendation for proposed sale of interest in bank to entity which had submitted the second highest bid, (2) in conducting sale, trustee was under no obligation to provide competing bidders with a precise valuation of the non-dollar components of their bids, and (3) competing bidder failed to establish any lack of good faith by successful bidder, even assuming that it qualified as an insider).
 - iv. Re-opening bidding after the auction is closed
 1. *See, e.g., In re Foamex International Inc.*, Case No. 09-10560 (KLC) (Bankr. D. Del. May 21, 2009) (considering the potential additional value to the estate, the court re-opened the bidding process where the debtor selected a bid \$5 million lower than the \$146.5 million all-cash bid of the stalking horse bidder).
 2. *Compare In re Finlay Enterprises, Inc.*, Case No. 09-14873 (JMP) (Bankr. S.D.N.Y. 2009) (bidding not reopened where objecting bidder did not make its best bid at the auction; court re-affirming compliance with bidding procedures)
- 3. Special Areas of Focus – Do Auctions in Bankruptcy Maximize Value, and if so, At What Cost**
- a. What assets *should* be permitted to be sold under Section 363(b) and outside of a Plan?
 - i. All or substantially of the Debtor’s assets
 1. While permitted, should such sales be allowed?
 2. Circumstances and safeguards
 - a. *See, e.g., In re RadioShack Corporation*, Case No. 15-10197 (BLS) (Bankr. D. Del. June 8, 2015 (approving a protocol for various wireless carriers and RadioShack in connection with the transfer of customer data to purchaser).
 3. Business judgment or entire fairness?
 - a. Disengaged boards
 - i. Committees
 - b. Should the board have to prove satisfaction of the standard

- c. Protections?
 - i. Engraft § 1129(a) protections?
- ii. Special Cases
 - 1. “Crown Jewels”
 - a. *Lionel* – “articulated business justification”? *See In re Lionel Corp.*, 722 F.2d 1063 (2d. Cir. 1983) (“[T]here must be some articulated business justification, other than appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under section 363(b)”).
 - 2. Assets “owned” by others – consigned good, assets licensed to the Debtor
 - a. *In re Whitehall Jewelers, Inc.*, 2008 WL 2951974 (Bankr. D. Del. Jul. 28, 2008) (requiring the debtor to first commence separate lawsuits against each of the 124 consignment creditors to determine ownership of the consigned goods before approving a sale); *In re Holladay House, Inc.*, 2008 WL 4682770 (Bankr. E.D. Va. Oct. 21, 2008) (upholding the Bankruptcy Court’s ruling that a consignment creditor had a perfected interest in only the inventory delivered under its consignment agreement with the debtor, and not also in all of the debtor’s other non-consigned inventory as the creditor had intended to obtain under its consignment and security with the debtor).
 - 3. Assets jointly owned
 - a. *See In re Gauthreaux*, 206 B.R. 502 (Bankr. N.D. Ill. 1997), (holding that detriment to co-owner from sale outweighed possible benefit to estate from the sale, and noting that “it is generally accepted that sale of a bankruptcy estate’s undivided one-half interest will generate substantially less than the sale of the entire property interest free of each owner’s interest because of the chilling effect the sale of such a limited interest has on prospective purchasers of the property, especially when the co-owner could continue to live on the property as is the case here.”); *In re Rozwick*, 231 B.R. 843 (Bankr. S.D.N.Y. 1999) (in regards to the proposed sale under §363(h) of property owned by a debtor bankruptcy attorney and his non-debtor spouse, the court stated that “once the trustee makes a *prima facie* case demonstrating that the estate would benefit from the sale of the residence, the burden shifts [to the nondebtor co-owner] to show facts indicating why the sale should not be approved.”).
 - 4. Assets to which personal, private information is attached

5. Compare Stephen Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 American Bankruptcy Law Journal 531 (2009) with Barry E. Adler, *A Reassessment of Bankruptcy Reorganization After Chrysler and General Motors*, 18 ABI Law Review 305 (2010).
- b. What “interests” can or should be affected by a “free and clear” sale under § 363(f)?
 - i. Liens
 1. Bona fide dispute
 - ii. Covenants “running with the land,” easements, etc.
 1. See *HPIP Gonzales Holding LLC v. Sabine Oil & Gas Corp.*, Case No. 16-4127 (S.D.N.Y. March 10, 2017) (upholding bankruptcy court decision holding that midstream gathering agreements are not covenants running with the land and may be rejected like any other executory contract); *In re Sabine Oil & Gas Corp.*, Case No. 15-11835, Doc. No. 872 (Bankr. S.D.N.Y. Mar. 8, 2016) (holding that rejection of three midstream agreements for gas and condensate gathering services as part of its bankruptcy proceeding was a reasonable exercise of its business judgment, but concluding that the gathering agreements at issue did not run with the land under Texas law). See also *In re Quicksilver Resources Inc.*, No. 15-10585 (Bankr. D. Del.); *In re Magnum Hunter*, No. 15-12533 (Bankr. D. Del.).
 - iii. Use restrictions
 - iv. Successor liability and other tort claims
 1. *Elliott v. Gen. Motors LLC*, 829 F.3d 135 (2d. Cir. 2016) (a bankruptcy court may approve a sale “free and clear” of successor liability claims if those claims flow from Chapter 11 debtor’s ownership of the sold assets, if the claims arose from a right to payment that arose prepetition or resulted from prepetition conduct fairly giving rise to the claims, and if there was some contact or relationship between debtor and claimant such that claimant is identifiable).
 - v. Labor agreements
 1. §§1113 and 1114 and ERISA
 - vi. Intellectual property rights
 - vii. Governmental Interests