

What's Your Bid?

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Judicial Concerns in Allowing Late-Upset Bids



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Bankruptcy is notable for its flexibility. An area where the bounds of flexibility are tested is when late-upset bids are received during a sale process. These late bids are a double-edged sword, as they may increase value to the estate but may also damage parties' expectations and ultimately undermine the debtor's reorganization prospects.

The tension between value-maximization and integrity of process is a fine line that courts repeatedly walk when considering late-upset bids. A recent ruling from the U.S. Bankruptcy Court for the Southern District of Texas addressed the tension that courts face when asked to permit a late overbid.

Bidding Procedures and the Auction Process

A debtor may sell property of the estate outside of the ordinary course of business, after notice and a hearing, pursuant to § 363(b) of the Bankruptcy Code. The debtor has a fiduciary duty to maximize value and consequently will seek to obtain the best price for the estate's assets.

Prior to the sale, the debtor develops and seeks approval of bidding procedures that will govern the submission of bids and conduct at the auction. The procedures will establish the auction date and time, fix a deadline to submit bids, and establish criteria for qualified bids and overbids. Once the auction concludes, the debtor submits the highest and best bid to the court for approval. Generally, the winning bid is for the highest dollar amount, although it might sometimes be facially lower than other bids if risk premium is ascribed to those bids.

Value-Maximization vs. Integrity of the Process

During a sale process, a court may face complex issues that require quick resolution, such as the submission of late or noncompliant bids and subsequent requests to reopen bidding. A late overbid creates tension between value-maximization and protecting the integrity of the sale process.¹ Reopening the bidding may result in increased value to the estate in the form of a substantially higher bid,² but it may chill bidding in future cases.

Parties may decline to bid on the assets of a bankruptcy estate if they cannot rely on the finality of a sale. Finality and regularity in process also ensure that bidders extend their best and highest offers at the auction, rather than after.³

Generally, courts reopen bidding under a "narrow range" of circumstances, such as where the initial sale price was "so grossly inadequate as to shock the conscience of the court" or where the original auction was "tainted by fraud, mistake, or some comparable defect."⁴ However, those circumstances are sometimes not present, such as when a party seeks to submit a late, but higher, bid. In those circumstances, courts balance the tension between value-maximization and integrity of the process, with some courts "employing a sliding-scale approach" where "the importance of estate enhancement diminishes as an auction participant's reasonable expectations, and the gravity of finality, increase."⁵

Effectively, the more the parties' expectations solidify, the less likely the court is to reopen bidding, except in circumstances involving a grossly inadequate price or fraud.⁶ Courts also consider the flexibility afforded in the approved bidding procedures.⁷

Sunland: Maximizing Value

The *Sunland Inc.* bankruptcy court considered whether the chapter 7 trustee could proceed with closing after the trustee received an upset bid one day after the judicial auction, and just prior to the hearing to approve the sale, that was

1 See *In re Fin. News Network Inc.*, 980 F.2d 165, 167 ("This appeal concerns the difficult balancing act a bankruptcy court must perform when it conducts an auction of a debtor's assets. It walks a tightrope between, on the one hand, providing for an orderly bidding process, recognizing the danger that absent such a fixed and fair process bidders may decline to participate in the auction; and, on the other hand, retaining the liberty to respond to differing circumstances so as to obtain the greatest return for the bankrupt estate."); *Corporate Assets Inc. v. Paloian*, 368 F.3d 761, 768 (7th Cir. 2004) ("Accepting a late bid may mean more money for creditors in the short run, but by upsetting the expectations of those who thought the bidding was at an end, it may in the long term undermine confidence in judicial sales and discourage prospective purchasers from making their best offers in a timely manner.")

2 See *In re Food Barn Stores Inc.*, 107 F.3d 558, 564-65 (8th Cir. 1997) ("[T]he court must also remain mindful of the ubiquitous desire of the unsecured creditors, and a primary objective of the Code, to enhance the value of the estate at hand.")

3 See *Id.* at 564.

4 *Corporate Assets Inc. v. Paloian*, 368 F.3d 761, 768 (7th Cir. 2004) (citations omitted); see also *Food Barn Stores Inc.*, 107 F.3d at 564.

5 *Id.* at 565.

6 *Id.*

7 *Id.* ("[W]e think that the important notions of finality and regulatory in judicial auctions are appeased if the court acts consistently with the rules by which the particular sale is conducted and in compliance with the bidders' reasonable expectations.")

25 percent higher than the winning bid.⁸ The bidding procedures provided that if one or more qualified bids were received, the qualified bidders and backup bidder would participate in an auction.⁹

The trustee received one qualified bid, and the qualified bidder ultimately made the highest bid at auction.¹⁰ At the same time, a potential bidder contacted the trustee requesting that the sale be postponed because it wanted to purchase the debtor's assets but was undergoing an acquisition.¹¹ Due to time and economic pressures, the trustee declined to postpone the sale.¹²

While the potential bidder received notice of the auction, it was focused on post-acquisition matters and erroneously believed that the assets had been sold.¹³ When the potential bidder learned that the sale had not yet closed, it immediately took steps to bid on the debtor's assets by contacting the trustee, transferring \$25 million to a title company and executing an asset-purchase agreement.¹⁴

Balancing process and value-maximization, the court applied a four-part analysis, considering (1) the bidding procedures and the bidders' reasonable expectations based on those procedures; (2) the amount of the overbid and the impact on creditors; (3) whether the new bidder acted in good faith; and (4) whether a sale order had been entered.¹⁵ While the court was "loath to disturb the results of a judicial auction," its "reluctance was counterbalanced" by the amount of the overbid, which would substantially benefit unsecured creditors, and bidding procedures that provided that the auction was subject to court approval.¹⁶

Instant Brands: Protecting the Process

A late 2023 ruling in *Instant Brands Holdings* also highlights the tension that courts grapple with when deciding whether to permit a late overbid.¹⁷ In this case, the debtors sought to sell substantially all their assets, which consisted of an appliances business line and a housewares business line.

An affiliate of Centre Lane initially submitted a \$344.8 million qualified bid for substantially all of the debtors' assets.¹⁸ However, an affiliate of American Securities submitted a \$125 million qualified bid for the appliances line, to which the debtors ascribed a \$7.4 million risk premium to account for the risk and cost of splitting the company between two separate bidders.¹⁹ At the debtors' request, Centre Lane split its qualified bid and allocated \$116.6 million of its bid to the appliances line.²⁰

After numerous rounds of bidding, Centre Lane was declared the provisional winning bidder of the appliances line for \$122.6 million, and the debtors adjourned the auction solely to enable the parties to finalize documentation before declaring Centre Lane the final winner.²¹ The following day, American Securities sought to submit a \$136 million bid for the appliances line, \$6 million more than Centre Lane's provisional winning bid.²²

At the debtors' request, the court held an emergency status conference to consider whether the bidding had closed.²³ While the debtors took no view as to how to handle American Securities' higher bid, the debtors believed that their bidding procedures and reservation of rights gave them the authority to consider American Securities' late bid.²⁴ The debtors also relied on the concept of value-maximization, reasoning that allowing American Securities' late overbid was "likely to result in a robust continuation of the auction and lead to ... potentially very material increased value to the estate."²⁵

American Securities and Centre Lane took opposite stances, however. American Securities argued that until the auction closed, the debtors had significant discretion to pursue the highest value of all stakeholders, while Centre Lane sought to keep bidding closed, drawing on the integrity of the judicial process, confidence in the sales process, and the importance of certainty in knowing that bidding is over.²⁶

After hearing the parties' arguments, the bankruptcy court found that the auction had closed and would remain closed unless the parties failed to reach acceptable final documentation.²⁷ The court emphasized the importance of process, even in the face of increased value: "[A] few more dollars is irrelevant ... in terms of protecting the integrity of [the] process. That matters first and foremost. Dollars never overcome that."²⁸

Conclusion

Whether to reopen bidding to allow a late-upset bid is a fact-sensitive question. Allowing a late bid does not guarantee increased value to the estate, in part because those bids are often accompanied by uncertainty. In some cases, the value increase is meaningful enough to justify accepting a late-upset bid to potentially increase value to the estate. However, allowing a late-upset bid also risks losing the original winning bidder, or worse, derailing the case. In those cases, a sale may never be consummated, pushing the debt-

⁸ *In re Sunland Inc.*, 507 B.R. 753, 758 (Bankr. D.N.M. 2014).

⁹ *Id.* at 756.

¹⁰ *Id.*

¹¹ *Id.* at 757.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at 757-58.

¹⁵ See generally *id.* at 759-61.

¹⁶ *Id.* at 762.

¹⁷ *In re Instant Brands Acquisition Holdings Inc.*, Case No. 23-90716 (Bankr. S.D. Tex.).

¹⁸ See Transcript of Auction and Bid Procedures at 9:3-13, *In re Instant Brands Acquisition Holdings Inc.*, Case No. 23-90716 (Bankr. S.D. Tex. Sept. 18, 2023), ECF No. 576-1.

¹⁹ See *id.* at 14:4-16:9, 18:9-20; see also Transcript of Emergency Status Conference at 2:19-4:7, *In re Instant Brands Acquisition Holdings Inc.*, Case No. 23-90716 (Bankr. S.D. Tex. Sept. 22, 2023), ECF No. 576-1.

²⁰ See Transcript of Auction and Bid Procedures at 9:21-10:3, *In re Instant Brands Acquisition Holdings Inc.*, Case No. 23-90716 (Bankr. S.D. Tex. Sept. 18, 2023), ECF No. 576-1; see also Transcript of Emergency Status Conference at 10:16-22, *In re Instant Brands Acquisition Holdings Inc.*, Case No. 23-90716 (Bankr. S.D. Tex. Sept. 22, 2023), ECF No. 576-1.

²¹ See Transcript of Auction and Bid Procedures at 22:9-24:25, *In re Instant Brands Acquisition Holdings Inc.*, Case No. 23-90716 (Bankr. S.D. Tex. Sept. 18, 2023), ECF No. 576-1. Centre Lane also was the provisional winning bidder of the housewares line with a bid of \$228.2 million, subject to final documentation, but the debtors were unable to obtain the requisite regulatory approvals, resulting in a termination of the housewares asset-purchase agreement. See Combined Disclosure Statement and Joint Chapter 11 Plan of Reorganization of Instant Brands Acquisition Holdings Inc. and Its Debtor Affiliates, *In re Instant Brands Acquisition Holdings Inc.*, Case No. 23-90716 (Bankr. S.D. Tex. Jan. 8, 2024), ECF No. 878.

²² See Transcript of Emergency Status Conference at 6:19-24, 9:3-9, *In re Instant Brands Acquisition Holdings Inc.*, Case No. 23-90716 (Bankr. S.D. Tex. Sept. 22, 2023), ECF No. 576-1.

²³ See *id.* at 39:4-8.

²⁴ See *id.* at 11:2-12:16.

²⁵ See *id.* at 10:16-22.

²⁶ See generally *id.* at 16:7-19:24, 31:8-33:23. The creditors' committee agreed that American Securities' bid may be a "potentially value maximizing development." *Id.* at 34:6-10.

²⁷ See *id.* at 39:20-40:6 ("Based upon my review of the transcript, I'm going to find that bidding was closed. There will be no further bids, absent a conclusion that acceptable documentation cannot be reached by the parties.")

²⁸ See *id.* 38:8-11, 40:23-41:2 ("The Court put the process above the end result. The process matters more than anything.")

continued on page 60

What's Your Bid?: Judicial Concerns in Allowing Late-Upset Bids

from page 29

or into chapter 7 or restarting the auction process, but with increased administrative costs to the detriment of creditors and the estate.

In some cases, a debtor may want to consider drafting flexible bidding procedures that allow it to reopen an auction to pursue increased value. In others where the debtor has limited liquidity to continue operating or other factors are driving a quick sale, the debtor may want firm bidding procedures that are clear on when

bidding and the auction closes to prevent an upset bidder from relying on loopholes or ambiguity to support a request to reopen bidding.

Potential bidders should be cognizant of the debtor's liquidity and the key factors driving a sale, such as cost and time constraints. If successful at the auction, the winning bidder should ensure that it is declared the winning bidder at the conclusion of the auction and that the auction has closed rather than adjourned, as was the case in *Instant Brands*. **abi**

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