

NAVIGATING ETHICAL ISSUES DURING ASSET SALES

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PROFESSIONAL COMPENSATION COMMITTEES



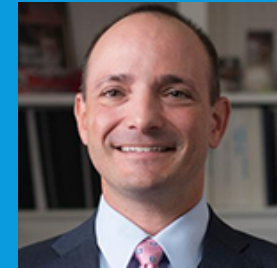
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ASSET SALE OF THE YEAR AWARD

- ABI's Asset Sales Committee has opened the application period for the 3rd Annual Asset Sale of the Year Award. Submissions are due by Friday, March 5, 2021. More information can be found on our committee page.
- All nominations should be sent directly to Dawn Cica at dcica@carlyoncica.com.

FIDUCIARY DUTIES: UNSECURED CREDITORS COMMITTEE

- The Official Committee of Unsecured Creditors (Committee) is a fiduciary body
- Duties of the Committee include the Duty of Care, Duty of Candor, Duty of Loyalty and Good Faith

FIDUCIARY DUTIES: NEIMAN MARCUS – WHAT HAPPENED

July 31, 2020. Call from Kamensky to Jefferies:

*"This conversation never happened. . . .
It's too late now. They're going to report
this to the U.S. Attorney's Office, okay? . . .
If you're going to go to continue to tell
them what you just told me, I'm going to
jail, okay? Because they're going to say
that I abused my position as a fiduciary,
which I probably did, right? Maybe I
should go to jail. But I'm asking you not to
put me in jail."*

NEIMAN MARCUS: KAMENSKY SETTLEMENT

- On September 25, 2020, settlement announced, with Kamensky agreeing to:
 - reimburse \$1.4 million to the debtors' estates for fees and costs;
 - subordinate his 2.15% interest in the Marble Ridge Master Fund to the interests of other creditors;
 - donate \$100,000 to charity and 200 hours of community service; and
 - agree under oath that nothing in the settlement will serve to cap the amount of loss that might be calculated in any future criminal proceeding.
- In approving the settlement, the Bankruptcy Court commented that it was doing so "reluctantly" and described Mr. Kamensky as a ***"thief ... of the lowest character"***.
- On December 11, 2020, the Bankruptcy Court entered an order approving the settlement agreement.

FIDUCIARY DUTIES: DEBTOR

- **Common temptations of Owner Debtors:**
 - Undisclosed agreements with bidders
 - Exclusivity
 - Coaching one bidder
 - Unreasonably denying access

KEEPING A QUESTIONABLE BIDDER IN PLAY

- What makes them questionable?
 - Hart-Scott-Rodino
 - Questionable financing
 - Provider agreement or franchisor agreements
- The bankruptcy court denied the request finding that the debtor's clever handling of the process was not "bad faith." See **In re HCL Liquidation, Ltd. (f/k/a Hussey Copper Ltd.)**, Case No. 11-13010 (BLS) (Bankr. D. Del. Oct. 21, 2011).

TRUE OR FALSE:

THERE WAS NO
COLLUSION
BECAUSE THE
CONVERSATION
WAS DISCLOSED?

- Two real estate developers, who are both interested in acquiring land cheaply, regularly share information. They both independently find an advertisement for a Section 363 auction of a promising commercial lot. When they realize they are both interested in the same property, they agree to combine their efforts, reasoning that “we’ll only hurt ourselves by bidding against each other!”
- The two real estate developers immediately disclose their decision to the Debtor and at the auction they notify all parties of their joint venture. There were no other bidders and their venture prevails at the auction for the minimum bid.

COLLUSION OR COLLABORATION

Section 363(n) requires that several things occur before the Trustee can either void the sale or seek damages:

- (1) there must be an agreement;
- (2) between potential bidders;
- (3) that controlled the price at bidding.

- It is probably NOT collusion if potential bidders collaborate on a bid, motivated for innocent reasons:
 - Formation of a favorable settlement agreement as discussed in In re Edwards
 - the inability of each collaborating party to afford an individual bid
 - Interest in different assets that are combined into one bid lot
- Disclosure is important but is not, in and of itself, a bulletproof defense

CASE STUDY: GRAND SOLEIL

- **Case No. 11-01632-NPO, Southern District of Mississippi** - hotel, B&B, and riverfront casino site. Three “bidders”
 - Cato – owned various parcels at times and was secured creditor
 - Berard – bought a previously uncontested first lien at face value and then formed entity to be DIP lender
 - Yates Construction – never got paid for design work, got yet another DOT
- It appears the liens were disputed in an attempt to prevent credit bidding. As a result, in order to credit bid, Berard had to post an irrevocable LC for the amount of claim and it created a cap on how much they could bid.
- 2 hours prior to auction, Cato and two lawyers for Yates, met and they signed a handwritten note, which was not disclosed.

THE AUCTION

- During the auction, Cato & Yates agreed to subordinate one loan to other, and did not disclose that
- Yates was high bid
- Berard was backup bid – they were limited by the constraints of the LC
- Cato then tried to bid but was rejected as not a qualified bidder
- Cato shows up on site later to take pictures
- Same day, at sale hearing, attorney for Yates is questioned and admits to Cato-Yates agreement - but doesn't mention the subordination agreement
- Debtor and Yates entered settlement agreement and at resumption of sale hearing, Yates withdraws bid, and debtor agrees to cancel. Approve Berard bid

THE CATO- YATES AGREEMENT

- The Cato-Yates Agreement provided:
 - *Cato Group & Yates Const.*
 - *Re: GS auction*
 - *--agree that*
 - *-- if Cato buys Williams Tract, Cato will: (1) enter design-build construction contract, using industry-standard terms, with Yates for construction of new casino under a \$23 million budget, and (2) pay Yates the principal amount of the Yates claim, approximately \$3 million, without interest, with payment according to terms to be agreed starting after construction is completed within [blank] years.*
 - *-- if Yates buys the Williams Tract, Yates will transfer it to Cato, and the above terms will apply, plus Cato paying the same purchase price as did Yates.*

BERARD CLAIMS

- The effect of the agreement between Yates Construction and the Cato was to lessen the amount of sales proceeds and to attempt to undermine the sale and claims processes. The agreement was designed to target and harm Berard as successor-in-interest to the rights of the acquired notes
- Yates Construction and Cato's actions in challenging Berard's rights unnecessarily complicated Berard's ability to credit bid without undue burden and expense
- By engaging in inequitable conduct, Yates and Cato sought to gain an unfair advantage and resulted in injury to the estate as well as Berard
- **The claims of Yates Construction and Cato should be equitably subordinated under 11 U.S.C. § 510(c) to the rights of all creditors of the estate.**

THE ETHICS / COLLUSION ISSUES TO DISCUSS

- If someone did not qualify to bid, hence is not a “bidder,” is their reaching an agreement with somebody collusion?
- Courts have routinely interpreted the term “potential bidders,” holding that the term can include parties that submit a bid, parties that express interest but do not submit a bid, the Committee of Unsecured Creditors, or the debtor itself.

THE ETHICS / COLLUSION ISSUES TO DISCUSS

- Once they withdrew as a bidder, what are the remedies for “inequitable conduct?”
 - Berard nor the Debtor, wanted to avoid the sale to Berard as the backup bidder
 - Equitable subordination of their liens
- The litigation ultimately settled before trial, so the legal effectiveness of the claims was not determined, but effective as a practical matter
 - Whether “collusion” or not, the court was left with the impression of “an attempt to cheat”
 - Claims were subordinated
 - Berard ended up with the property

TRUE OR FALSE:

THERE WAS NO
COLLUSION
BECAUSE BIDDER B
NEVER QUALIFIED
TO BID, BOTH
PARTIES WERE
INTERESTED IN
DIFFERENT
ASSETS, AND A
ROBUST AUCTION
WAS STILL
CONDUCTED.

- The day before a Section 363 auction of a fleet of offshore supply vessels, two prospective bidders have a quiet discussion, where potential Bidder A says he is mainly interested in part of the fleet (the lift boats), and potential Bidder B says he is only interested in another (the crew boats). Upon realizing this, they decide that only Bidder A is going to qualify to bid for the fleet and if he wins, will sell the crew boats to Bidder B. Bidder B never submits a bid before the auction begins and does not qualify to participate. Other bidders did qualify and after a robust round of bidding, Bidder A wins the auction. After the sale, he sells the crew boats to Bidder B.

DRIVING VALUE & AVOIDING COLLUSION

- Control of process - do not allow bidders to speak to each other
- Confirm that each bidder has no agreements and has not attempted to control price
- If you know a bidder can not qualify or has officially dropped out, you might encourage collaboration
- Disclosure, disclosure, disclosure (of any agreements or collaboration)
- Bid procedures that are flexible and encourage participation

BID PROCEDURES – CHILLING OR WELCOMING?

Chilling

- Excessive initial overbid and/or breakup fee
- Unreasonable requirements to qualify
- All or nothing bid requirements
- Inequitable diligence process
- Timing advantages for stalking horse
- Inequitable opportunity to negotiate variables other than purchase price
- Control over real estate or another asset

Welcoming

- Small initial overbid
- No right to credit bid breakup fee
- Easy to qualify
- Multiple bid lots to maximize flexibility
- Level playing field for diligence process
- Ample time to catch up
- Universally available agreements with

DISCLOSURE

- Disclaimers and as is where is
 - If in your materials, or in reps and warranties, and you know it to now be untrue, disclose. Common examples:
 - Projections
 - Key employees
 - Customers and contracts
 - Ethics and laws applying to real estate brokers and investment bankers under state laws and FINRA
 - Transparency
 - Materiality
 - Uniformity
- Model Rules of Professional Conduct for Attorneys
 - Rule 4.1:
 - A lawyer shall not knowingly . . . (a) make a false statement of material fact or law to a third person.”
 - Rule 8.4(c):
 - It is professional misconduct for an attorney to . . . engage in conduct involving dishonesty, fraud, deceit or misrepresentation.”

"EX PARTE" COMMUNICATIONS WITH DEBTOR OR AUCTIONEER

- There is no specific statute or rule that prohibits *ex parte* communication with a trustee, debtor or auctioneer engaged in an auction process.
- The concept derives from the Code of Judicial Conduct which provides generally "A judge shall not initiate, permit, or consider *ex parte* communications, or consider other communications made to the judge outside the presence of the parties or their lawyers, concerning a pending or impending matter[.]" Model Code of Judicial Conduct, Canon 2, Rule 2.9.

"EX PARTE" COMMUNICATIONS WITH DEBTOR OR AUCTIONEER (CONT.)

- While prohibition of *ex parte* auction communications is not codified, rules governing communications between estate professionals and potential bidders may be included in bid procedures.
- Even in the absence of a specific prohibition, bankruptcy courts have chastised parties for *ex parte* communications.
- When not prohibited by bid procedures, can the Debtor's professionals strategically engage in *ex parte* communications with bidders to get them to bid higher, and if so where is the line?

OTHER POTENTIAL ETHICAL ISSUES

- Turnaround manager as a bidder?
- Courts have strictly scrutinized sales to a party acting as fiduciary of the estate, but they are not barred per se. *See In re Bidermann Industries, U.S.A., Inc.*, 203 B.R. 547 (Bankr.S.D.N.Y.1997)
- Do disgruntled bidders have standing?
- Reopening the auction?

Q&A DISCUSSION

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Faculty: Navigating Ethical Issues During Asset Sales

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Kenneth Mann is a managing director with SC&H Capital in Easton, Md., where he provides distressed M&A advisory to private company business owners. He has personally handled unique sets of circumstances and found solutions for more than 300 middle-market businesses. With more than 25 years of experience, Mr. Mann specializes in everything from driving go-to-market strategies for engagements, interfacing with lenders and attorneys, negotiating offers and purchase agreements and conducting auctions, to testifying in court in support of the firm's clients' transactions. He is an active ABI member and a member of its Asset Sales and Investment Banking Committees. Mr. Mann has presented at many workshops for ABI and the Turnaround Management Association (TMA), as well as the Florida Bar and Mississippi Bankruptcy Conferences. He has been published in the *ABI Journal*, TMA's *Journal of Corporate Renewal*, *Asset Based Lending (ABL) Advisor* and *ABF Journal*. Mr. Mann is a registered real estate agent in Florida and holds hundreds of hours of continuing education related to commercial real estate, bankruptcy/insolvency, and maximizing returns in the sale of troubled companies. He

also has testified in numerous cases as an expert witness in bankruptcy courts regarding bid procedures and maximizing value in a sale. Mr. Mann is a FINRA Registered Investment Banking Representative (Series 79). He received his Bachelor's degree in business administration with a marketing concentration from Salisbury University.

Evelyn J. Meltzer is a partner with Troutman Pepper Hamilton Sanders LLP in Wilmington, Del., where she focuses her practice on corporate restructuring, bankruptcy and creditors' rights. She provides advice to clients regarding the risks, benefits, challenges and opportunities available in restructuring proceedings, and she has experience representing debtors, creditors' committees, asset-purchasers, landlords, liquidating and litigation trusts, assignees in assignments for the benefit of creditors (ABC), receivers, secured and unsecured creditors, and shareholders in bankruptcy proceedings. Ms. Meltzer has experience serving as counsel for both the debtor and creditor side in bankruptcy-related litigation matters. She is frequently invited to write and speak about current bankruptcy and insolvency issues. Ms. Meltzer is AV Peer Review Rated for Ethical Standards and Legal Ability by Martindale-Hubbell and co-chairs ABI's Asset Sales Committee. She received the 2016 Melnik Award for an Exceptional IWIRC Member and is admitted to practice in Pennsylvania and Delaware. Ms. Meltzer received her B.A. in political science from Drew University in 1998 and her J.D. in 2001 from Northwestern University School of Law.