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Where Federal Statutes Collide: What § 363 Does Not Clear Out

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CONCURRENT SESSION

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Where Federal Statutes Collide: What § 363 Does Not Clear Out and Other 363 Sale Issues

Bankruptcy Code Section 363

Section 363(b) of the Bankruptcy Code authorizes a debtor to use, sell or lease property outside of the ordinary course of business only after notice and a hearing.

Section 363(f) permits the sale of property free and clear of any interest in such property if on eof the following conditions are satisfied:

- Applicable non-bankruptcy law permit the sale of such property free and clear of such interest;
- The holder of the interest consents;
- 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;
- Such interest is the subject of a bona fide dispute; or
- The holder of such interest could be compelled to accept a money satisfaction of such interest.

Bankruptcy Code Section 363

Section 363 is intended to streamline asset sales and maximize the value of the debtor's assets for the benefit of creditors by allowing the purchaser to take free and clear of any interest.

- "Interest" is not defined in the Bankruptcy Code. Courts define it broadly to include liens, claims, encumbrances and successor liability.
- A sale consummated pursuant to Section 363 will thus provide benefits to a purchaser not available to a purchaser in a traditional nonbankruptcy sale.
- Courts have determined that the debtor has a fiduciary duty to obtain the highest and best price for the assets with the greatest certainty of execution.

Potential Government Objections and Statutory Impediments to a 363 Sale

- Objections from Committee on Foreign Investment in The United States ("CFIUS") through Foreign Investment Risk Review Modernization Act ("FIRRMA").
- Antitrust Related Issues.
- Objections from Environmental Agencies.

CFIUS Issues Relating to 363 Sale

Committee on Foreign Investment in the United States (CFIUS): Inter-agency committee charged with protecting national security by reviewing economic transactions (such as mergers and acquisitions) involving foreign entities possibly gaining access to national security-related technology and intellectual property thereby posing a threat to U.S national security.

- FIRRMA expanded CFIUS authority and scope.
- Bankruptcy had become an opportunity for foreign investors to circumvent federal regulations designed to prevent foreign investment and technology acquisition that impede U.S. national security.
    - In 2017, Chinese mining company Shenghe Resources acquired the mining rights to the ***sole*** rare earth mine (component of many defense technology products) in the U.S. when Molycorp auctioned off parts of the company as part of bankruptcy proceedings.
- In 2018, Congress passed FIRRMA to broaden scope of CFIUS review.
    - Added transactions that occur "pursuant to a bankruptcy proceeding or other form of default on debt" to the list of transactions over which CFIUS has jurisdiction. Previously CFIUS reviewed M&A related transactions.
    - Codified focus on acquisition if personal identifier information of U.S. Citizens.
    - Expanded jurisdiction to any non-passive investment in a US "critical technology company" or "critical infrastructure company"
    - Broadened definition of "Critical technology" to include emerging technologies that could be essential for maintaining or increasing the technological advantage of the US, especially with respect to national defense, intelligence and other areas of national security or seek to gain an advantage where one does not currently exist

CFIUS Issues: Spotlight on *GNC*

***In re GNC Holdings Inc.,* et al., Case No. 20-11662 (Bankr. D. Del.):** Debtors filed for bankruptcy in 2020 with more than $1 billion in debt and sought to either restructure or sell the company through an auction led by an affiliate of China's state-controlled Harbin Pharmaceuticals.

- Cancelled auction after lack of qualifying bids to compete with $770 million stalking horse offer from Harbin.
- Sen. Marco Rubio urged Treasury Sec. Mnuchin to direct CFIUS investigation into proposed sale over data security concerns; alleged Chinese government engaged in efforts to obtain private health information of Americans.
- CFIUS already had examined data security issues surrounding Harbin's earlier acquisition of a controlling stake in GNC; Harbin's increased control under the sale was disclosed but did not prompt another round of assessments.
- Court approved sale and Harbin purchased at least 1,400 of the chain's stores.

Potential Government Objections to a 363 Sale

Antitrust-Related Issues:

- §363(b)(2) acknowledges applicability of Hart-Scott-Rodino procedures to 363 sales
  - Standard HSR reporting thresholds apply to acquisition of an entity going through a bankruptcy process
    - Filing required (unless other exemption applies) if:
      - "Size of transaction" exceeds $92 million; *and*
      - Under "size of person" test, one party to the transaction has total assets or annual net sales of at least $184 million and the other has total assets or net sales of at least $18.4 million
    - "Size of transaction" can be difficult to determine until a buyer is approved by the bankruptcy court; might mean later determination that no filing was required
  - Multiple bidders permitted to file HSR, each with affidavit describing good-faith intent to complete the acquisition subject to approval of the bankruptcy court; debtor-in-possession files for entity to be acquired

Potential Government Objections to a 363 Sale

Antitrust-Related Issues:

- §363(b)(2)(B) changes timing of premerger processes:

	Standard Procedures	363 Sale Procedures
Initial Waiting Period	30 days	15 days
Response to "Second Request"	Both Parties	Only the acquiring party
Post Second Request Waiting Period	30 days after substantial compliance	10 days after substantial compliance

Potential Government Objections to a 363 Sale

Antitrust-Related Issues:

- Potential outcomes of antitrust review of 363 sale:
  - DOJ and FTC take no action and transaction proceeds after short delay
  - DOJ or FTC investigates acquisition, finds likely competitive harm, and reaches agreement with acquirer to divest assets to address competitive harm
    - *U.S. v. Dairy Farmers of America* (N.D. Ill. 2020)
  - DOJ or FTC investigates acquisition, acquirer complies with Second Request, and parties proceed to expedited litigation
    - *U.S. v. SunGard Data Systems/Comdisco (D.D.C. 2001)*
  - If no HSR filing required, DOJ or FTC seeks TRO to block acquirer from seeking bankruptcy court approval of purchase pending full antitrust investigation
    - *U.S. v. Tribune Publishing Co. (C.D. Cal. 2016)*

Potential Government Objections to a 363 Sale

Antitrust-Related Issues:

- *U.S. v. Dairy Farmers of America* (N.D. Ill. 2020)
  - Nov. 12, 2019: Dean Foods files for bankruptcy
  - Apr. 5, 2020: Bankruptcy court (S.D. Tex.) enters order authorizing 363 sale by Dean Foods to Dairy Farmers of America (DFA) of 44 milk processing plants
  - May 1, 2020:
    - DOJ files civil antitrust complaint to enjoin the acquisition
    - DOJ simultaneously files proposed consent decree under which DFA agrees to sell 3 plants to resolve competitive concerns
  - July 15, 2020: DFA's deadline to complete divestiture comes and goes
  - July 24, 2020: Court appoints Divestiture Trustee to assume responsibility for sale
  - Late 2020: Asset divestitures completed (only 2 of 3 plants ultimately sold)

Potential Government Objections to a 363 Sale

Antitrust-Related Issues:

- *U.S. v. SunGard Data Systems/Comdisco* (D.D.C. 2001)
  - July 16, 2001: Comdisco files voluntary Chapter 11 petition
  - Oct. 11, 2001: Comdisco assets sold at auction to SunGard
  - Oct. 22, 2001: DOJ sues to block transaction (one day before sale was to be submitted to bankruptcy court for approval)
  - Nov. 8, 2001: Court holds 10-hour evidentiary hearing
  - Nov. 14, 2001: Court rejects DOJ challenge to transaction

Potential Government Objections to a 363 Sale

Antitrust-Related Issues:

- *U.S. v. Tribune Publishing Co.* (C.D. Cal. 2016)
  - Nov. 1, 2015: Freedom Communications (*Orange County Register*) filed for Chapter 11
  - Mar. 11, 2016: Freedom receives bids for its assets from three bidders, including Tribune Publishing (*LA Times*)
  - Mar. 14, 2016: DOJ warns Freedom that it will sue if Freedom selects Tribune
  - Mar. 16, 2016: Freedom selects Tribune (and will seek approval on Mar. 21, 2016)
  - May 17, 2016: DOJ sues to block acquisition and seeks TRO
  - May 18, 2016: Court grants TRO
  - May 19, 2016: Freedom selects alternate purchaser

Potential Government Objections to a 363 Sale

Antitrust-Related Issues:

- Bankruptcy court jurisdiction to hear antitrust challenges
  - Government antitrust challenges to 363 sales frequently brought in federal district court
  - But at least one bankruptcy court has exercised jurisdiction to consider antitrust claim:
    - *In re Financial News Network, Inc.*, 126 B.R. 157, 161 (S.D.N.Y. 1991) (finding bankruptcy court "legally competent" to resolve antitrust issues, subject to ability of the government to seek withdrawal of the reference to the district court)

Potential Government Objections to a 363 Sale

Antitrust-Related Issues:

- Failing Firm Defense
  - Complete defense to an otherwise anticompetitive transaction
  - Applies if the acquired company:
    - would be unable to meet its financial obligations in the near future
    - would not be able to reorganize successfully under Chapter 11
    - made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its assets in the relevant market and pose a less-severe danger to competition than the proposed acquisition

Federal and State Environmental Agency Objections to 363 Sales

Environmental Agencies: Federal or state agencies may object to sales of property free and clear under section 363(f) in order to clarify that the buyer is liable to protect against environmental hazards to the public and in attempt to impose clean up and other ongoing obligations upon purchaser.

363(f): Environmental Liabilities

There are questions as to whether "free and clear" under Section 363(f) will shield a purchaser from environmental liabilities related to the purchased assets or the debtor's pre-sale actions.

- Successor Liability claims are viewed as an "interest" which a purchaser in certain circumstances can purchase assets free of clear of such claims.
- Complex interplay between environmental law and bankruptcy: Insulating purchasers from successor environmental liabilities may encourage competing buyers and maximize the value of a debtor's assets while environmental laws take on a "polluter must pay" approach.
- Some courts have held that section 363 sales can extinguish pre-petition or pre-sale environmental claims, but not claims arising after the conclusion of the bankruptcy case.
    - But this analysis can be further complicated by prepetition conduct "that has not yet resulted in detectable injury." *In re Matter of Motors Liquidation Co.*, 829 F.3d 135, 155 (2d Cir. 2016).
    - *In re Chrysler LLC*, et al., Case No. 09-50002 (Bankr. S.D.N.Y. June 1, 2009): Approved sale order enjoining third parties from asserting against the purchaser any and all claims and interests related to the sold assets (with a carve-out for governmental entities to enforce post-closing claims); the order expressly stated the purchaser was not liable under a successor liability theory for violations of environmental liabilities prior to entry of the sale order.
- Purchasers may request sale orders contain express language cutting off successor liability for pre-petition environmental liabilities, while federal or state agencies may request language preserving their enforcement of environmental liabilities under police and regulatory statutes.
- If environmental agency asserts money damages or asserts rights which has an alternative payment remedy rather than an obligation to clean up threatened or ongoing environmental issues than such action constitutes a claim therefor 363(f) can be used to sell free and clear of such claims.

Environmental Issues: Spotlight on *Exide*

In re Exide Holdings Inc. et al., Case No. 20-11157 (Bankr. D. Del.): In October 2020, Exide Holding Inc.'s plan was confirmed over opposition from California regulators over the debtors' abandonment of cleanup duties at a contaminated site.

- The property was shopped to buyers unsuccessfully due to the potential successor environmental liability and its maintenance costs.
- California regulators argued the state should not be responsible for future remediation efforts at the site.
- The court examined whether California successfully argued that an exception to abandonment applied under the SCOTUS' 1986 decision *Midlantic Nat'l v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 507 (1986), wherein a bankruptcy estate can be barred from abandoning a site if it puts public health and safety at risk.
- The court held that California did not make a convincing argument that there would be "imminent" or "immediate" threat to the public if the property was abandoned and taken over by the state, stating "The issue is not whether the lead at Vernon is dangerous – it is. The question is whether abandonment of the site presents an imminent danger – it does not."

363(f): Sale for Price in Excess of Liens

363(f)(3): A sale may be made free of liens if "the price at which the property is to be sold is greater than the aggregate value of all liens on such property."

- Debtor should not need to sell property free of liens if proceeds of the sale are earmarked for lienholders anyway and the estate will receive no benefit.

Sharp division among courts regarding meaning of "aggregate value of liens."

- One view is "aggregate value of liens" means actual ***economic value***, or "value" as determined under 506(a). *E.g.*, *In re Beker Indus. Corp.*, 63 B.R. 474, 476 (Bankr. S.D.N.Y. 1986) ("363(f)(3) is to be interpreted to mean what it says: the price must be equal to or greater than the aggregate value of the liens asserted against it, not their amount.")
- Opposing view is sale price must exceed the ***face amount*** of all liens. *E.g. Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25, 40 (B.A.P. 9th Cir. 2008) ("If [] 'aggregate value of all liens' means the aggregate amount of all allowed secured claims as used in § 506(a), then the paragraph could *never* be used to authorize a sale free and clear in such circumstances … when the claims exceed the value of the collateral that secures them."
    - "Aggregate value of all liens" therefore refers to their face value, not their economic value. If it were otherwise, section 363(f)(3) would effectively authorize a sale free and clear of all liens, whatever the amounts of claims they secured.

Section 363 Going Concern Sales

Courts are willing to approve a going concern sale - even if piecemeal liquidation or asset sales may yield more value - in order to preserve the debtor's business, protect jobs, and maintain customer bases and vendor relationships.

- *In re ICL Holding Co.*, 802 F.3d 547, 551 (3d Cir. 2015) ("The only way to avoid liquidation (a potential threat to [the debtor's] patients and a result that would leave the unsecured creditors and the Government with nothing) and allow the company to continue as a going concern was through a quick sale.").
- *In re TWA*, Case No. 01-00056, 2001 Bankr. LEXIS 980, *40 (Bankr. D. Del. April 2, 2001) ("There is a substantial public interest in preserving the value of TWA as a going concern and facilitating a smooth sale of substantially all of TWA' s assets to American. This includes the preservation of jobs for TWA's 20,000 employees, the economic benefits the continued presence of a major air carrier brings to the St. Louis region, and preserving consumer confidence in purchased TWA tickets American will assume under the sale.").
- "The process often has the advantages of speed and the ability to maximize asset value through sale of the debtor company as a going concern. It is not unusual for a §363 sale to be completed within two to three months after a bankruptcy filing. The assets are cleansed in that they are sold, with certain limited exceptions, free and clear of liens, claims and liabilities. Also, a §363 sale can often yield the highest price for the assets because of the buyer's ability to select liabilities it will assume and to purchase a going-concern business." Rob Steinberg, "The Seven Deadly Sins in §363 Sales", ABI Journal, 2005.

Faculty

David C. Kully is an antitrust partner in the Washington, D.C., office of Holland & Knight LLP, where his practice focuses on antitrust litigation, civil and criminal antitrust investigations by the antitrust enforcement agencies, and counseling clients on the requirements of the antitrust laws. He joined Holland & Knight in 2016 after an 18-year career with the Antitrust Division of the U.S. Department of Justice, where he led a 25-lawyer office responsible for investigating potential antitrust violations and litigating antitrust enforcement actions in the credit cards, real estate, sports, media (newspapers, television, radio and book publishing) and entertainment (music, movies, live entertainment) industries. His work with the government and in private practice has included matters in which the antitrust agencies have interceded to block the sale of assets through bankruptcy proceedings. Before joining the DOJ, Mr. Kully was in private practice at the Washington, D.C., office of a large international law firm and was recruited to participate as counsel in a special investigation conducted by the U.S. Senate Governmental Affairs Committee into campaign finance irregularities that arose during the 1996 federal election cycle. He received his B.A. in economics from Dartmouth College and his J.D. *magna cum laude* from Cornell Law School, where he was admitted to the Order of the Coif and served as editor of the *Cornell Law Review*.

Hon. Enrique S. Lamoutte is a U.S. Bankruptcy Judge for the District of Puerto Rico in San Juan, initially appointed in November 1986. He served as Chief Judge from 1986-98 and from 2009-18. He also served as a judge for the U.S. Bankruptcy Appellate Panel for the First Circuit, over which he presided as Chief Judge. Judge Lamoutte previously clerked for U.S. District Judge Hernan G. Pesquera of the U.S. Bankruptcy Court for the District of Puerto Rico and was chief of the Civil Division of the U.S. Attorney's Office. He is also a retired colonel of the Puerto Rico Air National Guard. Judge Lamoutte graduated from Boston College and the University of Puerto Rico Law School.

Kevin J. Simard is a partner with Choate, Hall & Stewart LLP in Boston and plays an active role in the management of various aspects of the firm. He has experience advising national banks and private lenders on all aspects of providing asset-based credit facilities to borrowers in various industries, with a particular emphasis on retail and consumer products. With a perspective on both the up-front structuring and the back-end winding down of facilities, he represent clients for the full life cycle of their deals, from the front-end structuring, negotiation and documentation of transactions, to workouts and restructurings, to bankruptcy and exit financings. Mr. Simard's clients have included Bank of America, Bank of Montreal, Callodine Commercial Finance, Carlyle Private Credit, Citizens Bank, Encina Business Credit, First Eagle Alternative Credit, Gordon Brothers Funding LLC, Pathlight Capital, SLR Credit Solutions and Wells Fargo. He has been at the center of some recent notable and high-profile retail bankruptcies in the country, including Sears Holdings, J. Crew, Brooks Brothers, The McClatchy Companies and Payless Shoes. Mr. Simard received his B.A. in 1986 from the College of the Holy Cross and his J.D. *cum laude* in 1989 from Boston College Law School.