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2020

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**Collusive Bidding on a Debtor's Assets: A Question of Fairness**

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Cite: *Collusive Bidding on a Debtor's Asset: A Question of Fairness*, 12 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 27 (2020)

**INTRODUCTION**

Section 363(n) of title 11 of the United States Code (the "Bankruptcy Code") prohibits "collusive bidding" -- a process where "the sale price [is] controlled by an agreement among potential bidders."<sup>1</sup> Section 363(n) only provides the *trustee* with the right to bring a claim of collusive bidding, [which if successful could undo a previously approved sale]. However, courts have allowed *unsuccessful bidders* to pursue such claims.<sup>2</sup> Further, unsuccessful bidders have the right to recover "any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount."<sup>3</sup>

Today, a lack of clarity exists regarding when an unsuccessful bidder may actually allege collusive bidding against a successful bidder. This memorandum explains this question by examining the following: (i) why an unsuccessful bidder may choose to invoke section 363(n) of the Bankruptcy Code; (ii) when an unsuccessful bidder will have standing; and (iii) the remedies available to prevailing unsuccessful bidders.

**I. Unsuccessful Bidder's May Invoke § 363(n) of the Bankruptcy Code to Allege Collusive Bidding**

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<sup>1</sup> 11 U.S.C. § 363(n).

<sup>2</sup> See *In re Waypoint Leasing Holdings Ltd.*, 607 B.R. 146, 156 (Bankr. S.D.N.Y. 2019).

<sup>3</sup> 11 U.S.C. § 363(n).

Section 363(n) of the Bankruptcy Code “prohibits agreements between potential bidders that are intended to control a sale price.”<sup>4</sup> Courts have interpreted this to mean that there must be an actual intent by potential bidders to impact the sale price, and that the price is tainted in a more than incidental manner.<sup>5</sup> Further, courts have noted that collusive agreements may occur in secret, *Id.* at 269, and may not be committed to writing.<sup>6</sup>

In *Boyer v. Gildea*, the District Court in the Northern District of Indiana found that collusive bidding had occurred and vacated the original sale.<sup>7</sup> There, the Debtor, GT Automation, filed for bankruptcy and later sought and received a court order authorizing the auction of their assets.<sup>8</sup> Among the bidders for the Debtor’s assets were Comerica and Arlington. Though Comerica had submitted the first bid, after a meeting between Arlington and the Debtor, the Debtor stopped negotiations with Comerica, and sold its assets to Arlington.<sup>9</sup>

Here, collusion occurred between the Debtor and Arlington. The District Court found that because the Debtor stopped negotiating with Comerica only after its meeting with Arlington “it [was] reasonable to infer that the decision to spurn Comerica...was due to...actions suggest[ing] that what occurred at the meeting was an agreement to work together to control the price at auction.”<sup>10</sup>

Alternatively, in *In re Miami General*, the United States District Court for the Southern District of Florida, did not find collusive bidding.<sup>11</sup> There, a hospital had declared bankruptcy and conducted an auction for the sale of its assets.<sup>12</sup> The unsuccessful bidder, General Health,

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<sup>4</sup> See *In re Colony Hill Assocs.*, 111 F.3d 269, 277 (2d Cir. 1997).

<sup>5</sup> See *Id.*

<sup>6</sup> *Trap Rock Corp.*, 42 F.3d at 753.

<sup>7</sup> *Boyer v. Gildea*, 475 B.R. 647, 668 (N.D. Ind. 2012).

<sup>8</sup> *Id.* at 649.

<sup>9</sup> *Id.* at 665.

<sup>10</sup> *Id.* at 654.

<sup>11</sup> See *In re Miami Gen. Hosp., Inc.*, 81 B.R. 682 (S.D. Fla. 1988).

<sup>12</sup> *Id.* at 683.

alleged that Miami General had colluded with C&S Health Corp. at a secret auction where C&S Health Corp. ultimately submitted a winning bid for the debtor's assets.<sup>13</sup>

Despite the unsuccessful bidder's allegation of collusion, the District Court found there had been no intent by potential bidders to impact the sale price, and that the Debtor, Miami General Hospital, had negotiated with not one, but multiple parties. The court ultimately held that in fact the Debtor made efforts to "stimulate the bidding by enabling other bidders to purchase the hospital at a higher price."<sup>14</sup>

## **II. To have Standing an Unsuccessful Bidder must fall within the "Zone of Interest"**

Section 363(n) of the Bankruptcy Code provides the trustee with standing to bring a claim of collusive bidding. However, an unsuccessful bidder may also be able to allege collusive bidding.<sup>15</sup> In order to have standing under 363(n) of the Bankruptcy Code, an unsuccessful bidder's claim "must fall within the zone of interests."<sup>16</sup> To find itself within the zone of interests, an unsuccessful bidder must have pecuniary interest in the sale, as "unsuccessful bidders who have had standing to challenge unfair transactions have had at least a hypothetical lost profit."<sup>17</sup> Though, "this rule is not absolute."<sup>18</sup> If an unsuccessful bidder does not have a pecuniary interest in the sale, "[c]ourts [may] properly entertain suits challenging the equity of a bankruptcy sale, on the assumption that sales tinged by fraud, mistake or unfairness would generally result in an accepted bid below that which might have been expected."<sup>19</sup> Courts have granted unsuccessful bidders standing only in these limited circumstances in order to "insure

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<sup>13</sup> *Id.* at 689.

<sup>14</sup> *Id.*

<sup>15</sup> *See Boyer v. Gildea*, 475 B.R. at 668.

<sup>16</sup> *In re HST Gathering Co.*, 125 B.R. 466, 467 (W.D. Tex. 1991).

<sup>17</sup> *Matter of, New Energy Corp.*, No. 12-33866, 2013, at 3 (N.D. Ind. June 28, 2013).

<sup>18</sup> *In re Hat*, 310 B.R. 752, 758 (Bankr. E.D. Cal. 2004).

<sup>19</sup> *Id.*

bankruptcy proceedings are not unreasonably delayed...by allowing only those persons whose interests are directly affected by a bankruptcy order to appeal.”<sup>20</sup>

#### A. Unsuccessful Bidder’s Pecuniary Interest

Applying the “zone of interest” test, the United States District Court for the Northern District of Indiana denied an unsuccessful bidder standing to claim collusive bidding under section 363(n) of the Bankruptcy Code because there was not a pecuniary loss suffered.<sup>21</sup> Here, the debtor, New Energy Corp., filed for protection under chapter 11 of the Bankruptcy Code for the purpose of “maximiz[ing] the value of its assets through a sale.”<sup>22</sup> The unsuccessful bidder, Natural Chem, submitted a \$25,000 bid deposit for the debtor’s assets, however, the bid deposit fell several hundred thousand dollars short, disqualifying Natural Chem from participating in the actual asset auction.<sup>23</sup> At auction, the winning bid came from two bidders, who together submitted a joint bid of 2.5 million dollars.<sup>24</sup> Prior to the sale being finalized, Natural Chem filed a motion opposing the approval of the sale claiming bidder collusion had occurred through the joint venture of the winning bid.<sup>25</sup>

The District Court found that Natural Chem’s claim fell outside the zone of interest.<sup>26</sup> The court found that Natural Chem did not suffer a pecuniary loss as it could not claim “that it would be able to submit a higher bid than the winning bid.”<sup>27</sup> Thus, the court ultimately found that Natural Chem did not have standing to allege collusive bidding under section 363(n) of the Bankruptcy Code.<sup>28</sup>

#### B. Bid Affected by Unfairness Falling Within the Zone of Interest

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<sup>20</sup> *New Energy Corp.*, No. 12-33866 at 3.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 1

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 3

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

Unsuccessful bidders may also have standing to claim collusive bidding when there is an assertion of claims that successful bidders “ruined the intrinsic fairness of the sale.”<sup>29</sup> To demonstrate this, an unsuccessful bidder must show that the sale was tainted by bad faith.<sup>30</sup> While not an exhaustive definition, courts have described bad faith as a successful bidder “tak[ing] grossly unfair advantage of other bidders.”<sup>31</sup>

For example, in *In Re Tri-Cran, Inc.*, the United States Bankruptcy Court for the District of Massachusetts found that the collusion of the successful bidders was enough to ruin the intrinsic fairness of the sale.<sup>32</sup> Here, a chapter 11 debtor filed a “Notice of Intended Private Sale” to sell all of its assets to John Fallon, a friend of the debtor, for \$480,000.<sup>33</sup> Although another prospective purchaser offered \$500,000 to the debtor, the bid was rejected and the assets of the debtor were sold to Fallon.<sup>34</sup> After the sale, there was an allegation that several of the Debtor’s stockholders “had engineered the sale to Fallon at a bargain price...[to] retain control of the property.”<sup>35</sup>

The *Tri-Cran Court* found that Fallon had indeed engaged in collusive bidding.<sup>36</sup> The court held that bad faith existed by the debtor “arranging to sell the property through insider dealing for the lower price the bankruptcy court would approve instead of...the highest price the estate could obtain.”<sup>37</sup> Further, Fallon had concealed his relationship with the debtor from the Court, which, had the court known, the sale “would not have been permitted to go forward.”<sup>38</sup>

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<sup>29</sup> *In re Colony Hill Assocs.*, 111 F.3d 269, 273 (2d Cir. 1997).

<sup>30</sup> *Wallach v. Kirschenbaum*, No. 11 CV 0795 SJF, at 4.

<sup>31</sup> *In re Gucci*, 126 F.3d 380, 390 (2d Cir. 1997).

<sup>32</sup> *In re Tri-Cran, Inc.*, 98 B.R. 609, 611 (Bankr. D. Mass. 1989).

<sup>33</sup> *Id.* at 612

<sup>34</sup> *Id.* at 613.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 611

<sup>37</sup> *Id.* at 619.

<sup>38</sup> *Id.*

*Tri-Cran* is a clear example of collusive bidding; yet bad faith may be found in alternative instances. In *Ramsay v. Vogel*, the Court held that an agreement between bidders to pay \$350,000 for a withdrawal of a bid, constituted bad faith.<sup>39</sup> The agreement was not disclosed to the court, had it been, the sale “would undoubtedly not have [been] approved.”<sup>40</sup>

Courts, however, are not so quick to announce a finding of bad faith, especially regarding failure to disclose certain assets and documents. In *Oren v. Kass*, when debtor filed for chapter 11 protection, Matthew Oren made a bid to acquire the debtor’s assets, however, the assets were ultimately sold to RB Asset.<sup>41</sup> Oren, the unsuccessful bidder, claimed collusion and bad faith by alleging that certain assets were never disclosed as part of the sale.<sup>42</sup> The court found this claim meritless as “the disclosure statement...approved by the Bankruptcy Court clearly describes the assets to be sold.”<sup>43</sup> Similarly, the Court in *Dick’s Clothing and Sporting Goods*, held that failing to disclose non critical documents to the Court is not enough for a finding of bad faith.<sup>44</sup>

Courts are also reluctant to hold that a bidder’s extensive knowledge about the Debtor’s industry, more so than other bidders, is enough to be considered bad faith. In *In re Cable One CATV*, it was alleged that the successful bidder, First Carolina, gained a “grossly unfair advantage [over] other bidders” due to their status as an informed party.<sup>45</sup> However, the bankruptcy court summarily dismissed this claim, stating it was not even “germane to the question before the court.”<sup>46</sup>

### **III. Remedies Available to Unsuccessful Bidders Under 363(n)**

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<sup>39</sup> *Ramsay v. Vogel*, 970 F.2d 471, 473 (8th Cir. 1992).

<sup>40</sup> *Id.* at 474.

<sup>41</sup> *Oren v. Kass*, No. CV-04-4297, at \*3 (E.D.N.Y. Sept. 23, 2005).

<sup>42</sup> *Id.* at 6

<sup>43</sup> *Id.* at 8.

<sup>44</sup> *Dick's Clothing & Sporting Goods, Inc. v. Phar-Mor, Inc.*, 212 B.R. 283, 295 (N.D. Ohio 1997).

<sup>45</sup> *In re Cable One CATV*, 169 B.R. 488, 493 (Bankr. D.N.H. 1994).

<sup>46</sup> *Id.*

If a court makes a finding of collusion, the sale at issue will be set aside. However, An unsuccessful bidder that is able to prove collusion is not left without an option to seek monetary damages. Rather, an unsuccessful bidder “may seek consequential damages in the amount of the difference between what the property sold for and what it should have sold.”<sup>47</sup> Additionally, the unsuccessful bidder will have an opportunity to recover costs such as attorney’s fees, and may even seek punitive damages.<sup>48</sup>

Bidders that engage in collusion may also be held criminally liable.<sup>49</sup> Though the courts have not addressed criminal liability in this context, and despite a lack of commentary on the matter, there are at least two statutes under which a colluding party could be prosecuted criminally.<sup>50</sup> Section 152 of Title 18 asserts that in a bankruptcy case “a party can be held criminally liable for knowingly...making a false oath or filing a false statement under penalty of perjury.”<sup>51</sup> Furthermore, under Section 157 of Title 18, bidders may be held criminally liable for false or fraudulent schemes in connection with a bankruptcy case.<sup>52</sup>

## **Conclusion**

Collusive bidding is not permitted under section 363 (n) of the Bankruptcy Code. However, unsuccessful bidders do not necessarily have standing to bring a claim alleging collusion. In general, an unsuccessful bidder may pursue a claim of collusive bidding and attempt to set aside a sale only if its allegations fall within the “zone of interest.” Ultimately, if the court finds that collusive bidding did occur, an unsuccessful bidder may be entitled to

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<sup>47</sup> Jason Binford, *Collusion Confusion: Where Do Courts Draw the Lines in Applying Bankruptcy Code Section 363(n)?*, 24 Emory Bankr. Dev. J. 41, 70 (2008).

<sup>48</sup> *Id.* at 71.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*



consequential damages in the amount of difference between what the property sold for and what it should have sold.