

Client Alert

Finance and Restructuring Practice Group

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“All Sales Final”: First Circuit Defends Bankruptcy Sale Against Spurned Bidder Attack

Affirming the Bankruptcy Code’s aversion to upsetting court-approved sales on appeal, on January 12, 2018, the U.S. Court of Appeals for the First Circuit held that a bankruptcy court’s “good-faith” finding protected a bankruptcy sale from appeal by a spurned bidder that claimed the auction sale was tainted by collusion and fraud. The case, *In re Old Cold, LLC*, underscores the importance of bankruptcy sale buyers seeking a good-faith finding and waiver of the automatic 14-day stay of orders when asking a bankruptcy account to approve a sale.

Background and Bankruptcy Court Decision

When the financial condition of Tempnology, LLC deteriorated to the point that it could no longer remain viable, the company filed a chapter 11 bankruptcy case and quickly sought a court-approved asset sale. Tempnology accepted a stalking-horse offer from Schleicher and Stebbins Hotels LLC (“S&S”), a secured lender that held a majority equity interest in Tempnology and controlled two members of Tempnology’s management committee prior to the filing. The S&S offer of \$6.95 million consisted of forgiveness of existing secured debt owed to S&S. This stalking-horse offer was followed by an auction, at which Mission Product Holding, Inc. (“Mission”) offered \$1.5 million cash. After a day-long auction process, Tempnology accepted an offer from S&S for \$2.7 million in debt forgiveness, the assumption of certain debts, and leaving cash and certain assets in the estate. Following a two-day evidentiary hearing, the bankruptcy court approved the sale and included in its order language waiving a default rule staying the order’s effect for 14 days. The court specifically found no evidence of collusion or misconduct between Tempnology’s management and S&S, and found that S&S was a “good-faith purchaser” within the meaning of Bankruptcy Code section 363(m).

Mission appealed the bankruptcy court’s decision to a bankruptcy appellate panel, which affirmed the sale order. The appellate panel cited the “finality rule” of Bankruptcy Code section 363(m), which provides that the successful appeal of a sale order will not disturb the sale if the buyer acted in good faith, and if the sale is not stayed pending appeal. Mission appealed the panel’s ruling to the First Circuit Court of Appeals.

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The First Circuit's Decision

Mission argued that S&S—a Tempnology insider by virtue of its equity ownership and management influence—was not a “good-faith purchaser.” Mission also complained that the bankruptcy court should have been required to leave the 14-day stay in place, giving Mission a short window to seek reversal on appeal. The First Circuit disagreed on both counts. It first held that the bankruptcy court’s finding that S&S and Tempnology did not collude was entitled to deference from the reviewing courts. The bankruptcy court did not clearly err in finding that S&S was a good-faith purchaser because: (a) S&S and Tempnology, while related to each other, negotiated the sale at arms-length, without evidence of excessive control by S&S; (b) S&S gave value for what it bought (the cash and debt assumption purchase price); and (c) S&S did not have knowledge of any adverse claims, such as pending litigation over title to the assets. (Mere objections to the sale by a spurned bidder do not create “adverse claims.”) S&S was a good-faith purchaser.

The First Circuit also rejected Mission’s second argument, that the bankruptcy court was not permitted to waive the 14-day stay imposed by Bankruptcy Rule 6004(h). The First Circuit noted that the waiver language of the sale order had been provided to all potentially objecting parties, including Mission. Because the sale needed to close quickly to avoid additional costs to the bankruptcy estate, the bankruptcy court properly waived the 14-day notice. Because the sale had not been stayed, and S&S was a good-faith purchaser, the First Circuit refused to consider the merits of Mission’s substantive objections to the sale. The sale would not be disturbed.

Wider Implications of *Old Cold* For Bankruptcy Sale Buyers

The *Old Cold* decision emphasizes the importance to asset buyers of ensuring that a bankruptcy court sale order is insulated from attack on appeal. Bankruptcy Code section 363(m) provides a powerful shield against appeals, but it only works when the successful bidder (or debtor) presents evidence that the bidder is a good-faith purchaser. Additionally, a waiver of Bankruptcy Rule 6004(h)—standard language in many bankruptcy sale orders—should be provided to creditors before the sale hearing, so they have a harder time challenging the waiver once it is approved. These two seemingly-innocuous provisions will go a long way to protecting a successful purchaser from appeals by unsuccessful rivals.

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