LEGAL *Bulletin*

Antitrust Concerns May Block Section 363 Sales

Bankruptcy Court Orders May Not Be as Bulletproof as They Seem

BY RYAN K. COCHRAN, PARTNER; KATIE GRAINER STENBERG, ASSOCIATE, & BOBBY GUY, PARTNER, WALLER LANSDEN DORTCH AND DAVIS, LLP

A Bankruptcy Code Section 363 sale is often the exit strategy of choice for distressed companies and their suitors. There are a number of reasons for this, one of the most important being the ability to get a Bankruptcy Court to issue an order blessing the sale and protecting the buyer from prickly liabilities. With Chapter 11 filings now predicted to hit historic highs and Wall Street's remaining liquidity sources lost in a sea of confusion, the prevalence of 363 sales is likely to increase dramatically.

Any decision that rocks the boat for 363 sales is worthy of attention, and in the last year, a furor has surrounded the decision of *Clear Channel Outdoor, Inc. v. Knupter (In re PW, LLC)*,[1] which has far-reaching implications for buyers and senior lenders. In the shadow of *Clear Channel*, however, one significant decision in the 363 realm seems to have escaped notice — the ruling of the 11th U.S. Circuit Court of Appeals in *Gulf States Reorganization Group, Inc. v. Nucor Corp.*[2]

There, the court found that a buyer can be sued by a disappointed bidder for antitrust violations simply based on a successful bid at a 363 auction, even when the Bankruptcy Court finds the purchase was made in good faith and no other evidence of wrongdoing exists. Unsettling? The authors thought so, too. The winds of *Gulf States* could chill the bidding at many a bankruptcy sale.

Losing Bidder Fights Back

Gulf States Steel Inc. of Alabama was a producer and retailer in the southeastern market of hot rolled coil, which is used for such items as highway guardrails. Business declined, and Gulf States filed for Chapter 11 bankruptcy protection in 1999. The Chapter 11 was short-lived, however, and Gulf States soon ceased operations and converted to Chapter 7.

The insiders formed a new company to try to purchase the assets, aptly naming it Gulf States Reorganization Group, Inc. (GSRG). GSRG made several unsuccessful attempts to purchase the assets through private negotiations with the trustee and a failed auction.

> The trial court relied heavily on the Bankruptcy Court's lengthy 363 sale order. Such orders usually are viewed as the closest equivalent to Kevlar that can be bought by a distressed asset purchaser.

Finally, in 2002, GSRG had high hopes of acquiring the assets of Gulf States in a private sale without an auction, which was to be allowed by the Bankruptcy Court as long as no other suitors appeared.

GSRG's hopes were dashed when a major competitor in the southeastern hot rolled coil market, Nucor Corp., submitted a bid for Gulf States' assets, triggering an auction. Nucor created a joint venture with a third party, financed the joint venture, and had the joint venture act as the buyer at the auction.[3] Nucor's bid made for a lively bankruptcy auction — Nucor and GSRG made 22 alternating cash bids for the assets. The last all-cash bid was submitted by Nucor for $6.3 million.[4]

At that point, GSRG was priced out of the purchase and attempted to offer part cash and part debt. This bid was rejected, and the Bankruptcy Court approved the sale of the assets to Nucor's joint venture as the highest and best bidder. GSRG objected, but raised no antitrust issues in its objection.

Following the auction, prices in the Asian market for steel assets rose dramatically. Nucor resold the assets to the Asian market 1½ years after its purchase for more than twice the amount of its successful bid.[5]

A little more than a month after the auction, GSRG sued Nucor in U.S. District Court for antitrust violations, claiming that Nucor was a monopolist in the hot rolled coil market and that its participation in the auction violated antitrust law. In essence, GSRG contended that it was excluded from the southeastern market for hot rolled coil by being outbid at the bankruptcy auction. GSRG also claimed that Nucor had kept its interest in the buyer entity secret so that the Bankruptcy Court had neither considered nor rejected the antitrust contentions, and that the terms of the joint venture deal between Nucor and its third-party partner evidenced Nucor's anti-competitive intent.[6]

The court rebuffed GSRG, finding that a disappointed bidder should not be allowed to bootstrap its failed auction bid into an antitrust claim, especially when there was a full and fair bankruptcy auction process. The trial court relied heavily on the Bankruptcy Court's lengthy 363 sale order. Such orders usually are viewed as the closest equivalent to Kevlar that can be bought by a distressed asset purchaser.

The Bankruptcy Court had found that the assets were properly exposed to the marketplace, allowing maximization of interest in

continued on page 14

continued from page 13

bidding on the assets; that there was no collusion or bad faith motive on the part of the trustee or any bidder, and all negotiations and bidding were arms length; and that the sale to Nucor was consistent with the bankruptcy trustee's sound business judgment.[7]

Notably, GSRG admitted that the amount ultimately paid by Nucor for the assets was more than GSRG could pay for them and that the auction had obtained the highest price for the bankruptcy estate. In addition, GSRG consisted of insiders of the debtor trying to buy back the company of which they had (predictably) lost control in the bankruptcy process. Hardly an antitrust problem, right?

On appeal, however, the 11th Circuit found that GSRG's assertions stated a claim for an antitrust violation, reversed the trial court, and sent the case back so that the matter could proceed to trial. The appellate court found that GSRG had shown an antitrust injury by demonstrating that it was excluded from the relevant market by being outbid at the auction and that this was sufficient to state a claim for alleged harm to competition.

The 11th Circuit made clear that it was not expressing any opinion with respect to the merits of the case as a whole (*i.e.*, whether the actions of Nucor substantially lessened competition in the relevant market and violated the antitrust laws), and left it to the trial court to conduct this analysis. However, the implications for turnaround professionals on whether winning a bankruptcy auction can somehow constitute an antitrust violation against disgruntled former insiders or disappointed bidders are more than significant.

Implications of *Gulf States*

1. No Insulation from Antitrust Claims. Buyers are not insulated from antitrust claims by normal Bankruptcy Court approval pursuant to Section 363 in view of *Gulf States*. The 11th Circuit's decision makes clear that antitrust hinges on the competitive effects of the proposed purchase on the relative market (here, the southeastern steel market) and not on the level of competition at the bankruptcy auction.[8] Because the relevant inquiry is the impact on competition in the marketplace, a Bankruptcy Court's finding that an auction was governed by full and fair competition does not insulate a bidder from an antitrust claim, according to the 11th Circuit.

The goal of a bankruptcy auction is to ensure that a sale is conducted in a manner that generates the highest return for creditors; accordingly, it is possible that a Bankruptcy Court may approve a bid as the highest return for creditors, without making a determination of whether the acceptance of the bid will have anticompetitive effects on the market overall. For the same reason, the standard "good faith" finding in a 363 sale order may not be sufficient to insulate a buyer from antitrust claims.

Because the relevant inquiry is the impact on competition in the marketplace, a Bankruptcy Court's finding that an auction was governed by full and fair competition does not insulate a bidder from an antitrust claim, according to the 11th Circuit.

This does not mean, however, that a buyer cannot obtain findings from the Bankruptcy Court regarding antitrust issues. A Bankruptcy Court is legally competent to resolve antitrust issues raised in proceedings before it,[9] and trustees, prospective bidders, and stalking horse bidders all can bring antitrust concerns before the court to review before approving a sale. The review must include a review of the purchase in the relevant market rather than just the propriety of the auction process.

Accordingly, in scenarios in which antitrust is a potential issue, buyers should consider adding a finding (and proffering evidence) that the effect of the 363 sale to the winning bidder is not anticompetitive in the relevant market.

2. Potential Safe Harbors, Defenses for Buyers. Antitrust law was implicated in *Gulf States* because the assets available in the bankruptcy auction "would constitute substantially all of the assets necessary for a potential entrant into the market to begin operations and compete."[10] On the other hand, when a dominant firm purchases at auction an isolated piece of commonly available equipment necessary for its ongoing operations and wins out against a competitor or new entrant, such an isolated transaction does not implicate antitrust law.

Thus, bidding for certain pieces of a distressed company is unlikely to create an antitrust issue. Of course, this is not much help to buyers, as most of them want to purchase a distressed business as a whole to maintain enterprise value and certain synergies that exist in an already-formed company.

Another potential protection from antitrust claims for a Section 363 buyer is the "failing company defense," an exception to antitrust law that allows a dominant firm to purchase assets of a competitor that is about to leave the relevant market. In this circumstance, the dominant firm is allowed to purchase the competitor even if the purchase might lessen competition. The reasoning is that the threat to competition is preferable to the injury to stockholders and communities if the failing company goes out of business.[11]

The applicability of this defense for Nucor has yet to be decided in the *Gulf States* case.[12] Unfortunately for Section 363 bidders, however, one element of the failing company defense is that the proponent of the sale or merger must demonstrate that there is no other viable alternative purchaser.[13] Thus, it can be difficult to apply the defense to the bankruptcy auction process, as there is usually more than one bidder and it may be difficult to demonstrate that there is no other preferable purchaser.[14]

Another potential tool for buyers is the Hart-Scott-Rodino Improvements Act (HSR). HSR requires a pre-merger/pre-acquisition filing for certain transactions, usually acquisitions of more than $65.2 million or acquisitions that result in combining two companies, one of which has annual net sales or total assets of $130.3 million and the other of which has annual net sale or total assets in excess of $13 million.[15] When HSR applies, a proposed transaction must be reviewed by the Department of Justice or the Federal Trade Commission (FTC), and HSR is incorporated into Section 363 by the Bankruptcy Code.

Many Section 363 sales do not rise to the threshold HSR level, and thus, it may not be much help. In addition, HSR does not protect a successful bidder from antitrust claims asserted by the state or a private party. Thus, in *Gulf States*, even had the matter risen to the HSR threshold, HSR review would not have prevented GSRG bringing suit against Nucor.

Finally, if the stakes are high enough, a bidder always has the option to submit the proposed transaction to the FTC and/or the Department of Justice for a voluntary business review. In *Gulf States*, GSRG contacted the FTC, but the commission refused to take any action.[16] Although the business review process has no precedential value, it can be persuasive and thus helpful in the event of a later attack like the one brought by GSRG.

Of course, a decision to seek a business review should not be entered into lightly; a tiger can be tough to control once it has been invited into the living room. This process may be most beneficial when a bidder believes its greatest exposure to an antitrust claim is not

from the government but from an aggrieved private party, and the situation appears likely to spawn litigation.

One More Worry

To most insolvency practitioners, it may seem inconceivable that insiders of a failed debtor could sue the winning bidder for buying the debtor's assets — especially based on the assertion that the insiders are being excluded from participating in the industry in which they just went bankrupt. Bidding at Section 363 sales almost always involves competitors who stand to gain market share. Apparently, however, insiders and other disappointed bidders may have a viable claim under appropriate circumstances, such as when there is potential monopoly power.

Thus, antitrust is now one more issue that practitioners should consider analyzing in the context of a distressed purchase. CR

[1] *Clear Channel Outdoor, Inc. v. Knupter (In re PW, LLC)*, 391 B.R. 25 (B.A.P. 9th Cir. 2008).

[2] *Gulf States Reorganization Group, Inc. v. Nucor Corp.*, 466 F. 3d 961 (11th Cir. 2006), rehearing and rehearing *en Banc* denied, 231 Fed. Appx. 945 (11th Cir. 2007), *cert. denied*, 127 S. Ct. 2920 (2007).

[3] For purposes of ease in this article, the buyer is referred to simply as Nucor, although the buyer was actually the joint-venture affiliate.

[4] See Nucor Brief, 1:02-CV-02600-RDP (N.D. Ala. 2002), Dkt. 83 at 1.

[5] See *Gulf States Reorganization Group*, 466 F.3d at 964; *Gulf States Reorganization Group, Inc. v. Nucor Corp.*, No. 1:02-CV-2600-RDP, 2005 WL 3797400 (N.D. Ala. 2005).

[6] Specifically, GSRG argued that the joint-venture deal struck between Nucor and its third-party partner evidenced Nucor's anti-competitive intent because it made the deal risk-free for the third party. GSRG also argued that Nucor's reservation of rights in the joint venture, to approve a subsequent sale of the assets by the joint venture to any domestic buyer, was an effort to stop a sale to any group that planned to put the steel assets into production in competition with Nucor.

[7] *Gulf States Reorganization Group., Inc.*, 2005 WL 3797400 at *5.

[8] See *Gulf States Reorganization Group*, 466 F.3d at 968.

[9] See *In re Financial News Network, Inc.*, 126 B.R. 157, 161 (S.D.N.Y. 1991).

[10] See *id.* at 967.

[11] See *United States v. General Dynamics Corp.*, 415 U.S. 486, 507 (1974).

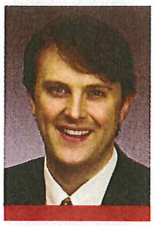
[12] See *Gulf States Reorganization Group*, 466 F.3d at 967.

[13] See *Dr. Pepper/Seven-Up Cos., Inc. v. Federal Trade Commission*, 991 F.2d 859, 865 (D.C.Cir. 1993).

[14] See *General Dynamics Corp.*, 415 U.S. at 507. ("A company invoking the defense has the burden of showing that…it tried and failed to merge with a company other than the acquiring one."); see also *Dr. Pepper/Seven-Up Cos., Inc.*, 991 F.2d at 865 (noting that bankruptcy auction did not produce other viable bids).

[15] See generally 15 U.S.C. Section 18a.

[16] See *Gulf States Reorganization Group*, 466 F.3d at 964.



Ryan K. Cochran (top photo) and Bobby Guy (middle photo) are partners and Katie Grainer Stenberg (bottom photo) is an associate at Waller Lansden Dortch and Davis, LLP. Cochran and Stenberg practice in the area of bankruptcy and insolvency law, and Guy practices in the area of insolvency law and distressed acquisitions. Cochran can be reached at ryan.cochran@wallerlaw.com, Stenberg can be reached at katie.stenberg@wallerlaw.com, and Guy can be reached at bobby.guy@wallerlaw.com.

The authors would like to thank Alan L. Marx of King & Ballow and Beth Vessell of Waller Lansden Dortch & Davis, LLP, for their advice in connection with the drafting of this article.