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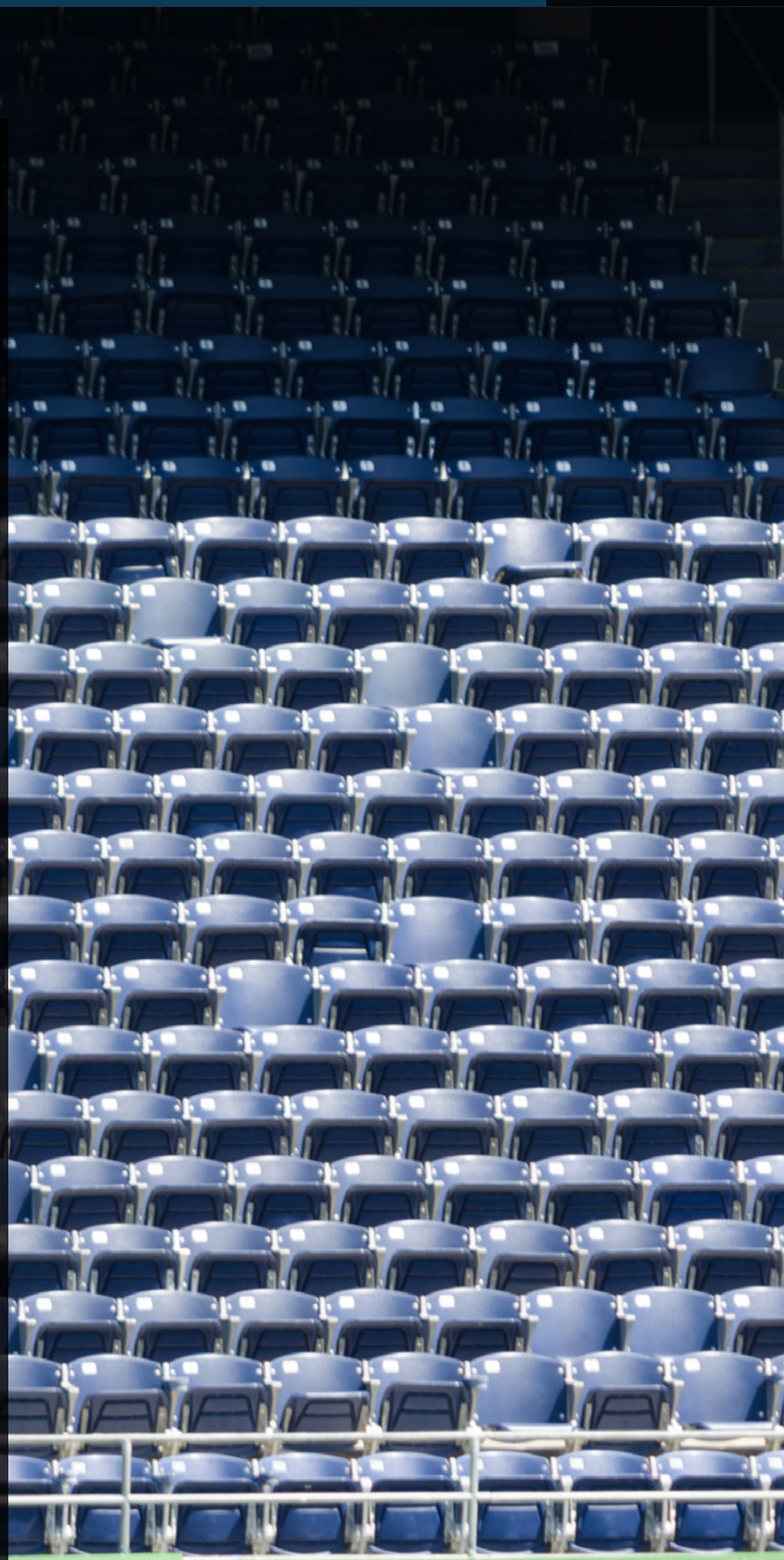
WHAT'S INSIDE



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KEY U.S. ANTITRUST ISSUES IN BANKRUPTCY SALE-TRANSACTIONS[1]

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The COVID-19 pandemic has created significant financial distress for many businesses and there have been a number of bankruptcy filings recently,[2] with more likely on the horizon. As a result, there is likely to be an increase in acquisitions of companies or assets out of bankruptcy.[3] Companies considering bankruptcy sale-transactions need to consider the structure that best suits their needs—e.g., a " 363 sale" offering a separate sale process and potentially speed, or a sale as part of the plan of reorganization or liquidation plan, which allows for the sale to be incorporated into the plan process. It also is important to recognize that just because a target has filed—or is likely to file—for bankruptcy, does not mean that the transaction is immune from the antitrust laws. Parties to transactions meeting certain thresholds must file notification with the Federal Trade Commission and Antitrust Division of the Department of Justice and observe a waiting period prior to closing. And, the US antitrust authorities will continue to scrutinize and investigate transactions raising substantive antitrust issues—whether meeting the threshold for filing or not. Both the filing and substantive review occur independent of the bankruptcy court's approval.

Below is a summary of the key issues to consider when contemplating acquisitions in bankruptcy, especially those that may raise antitrust issues.

Bankruptcy Overview

There are a number of considerations for a company when contemplating acquiring the assets of a distressed company; one is whether to acquire the assets pursuant to a section 363 sale or a sale under a confirmed plan of reorganization/liquidation.

363 Sale

In a sale pursuant to section 363 of the Bankruptcy Code, a buyer typically negotiates a purchase and sale agreement (PSA) pursuant to which the buyer agrees to acquire all or certain of the assets of the target company, and agrees on the liabilities that the buyer is willing to assume in connection with the acquisition of the identified assets. The parties also agree upon the contracts that will be assumed and assigned to the buyer in connection with the acquisition of the identified assets. In connection with the negotiation of the PSA, the buyer and target company also negotiate the terms and conditions of bidding procedures that will be operative in connection with the sale of the assets pursuant to the PSA. These procedures generally include, among others, a "break-up fee" and "expense reimbursement" that will be payable to the buyer if a third-party outbids the buyer at any auction.

Under the sale process described above, the buyer is often referred to as the "stalking horse bidder" and the requisite PSA and associated bid procedures to be implemented in connection with the sale of the assets to the stalking horse bidder are generally fully negotiated between the buyer and the target company prior to the commencement of the bankruptcy proceedings. In this scenario, the fully negotiated PSA and bid procedures, and the motions seeking the approval of the PSA and the bid procedures, are then submitted to the bankruptcy court for approval at the same time (or close in time) to the commencement of the bankruptcy proceedings.

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2 For example, as of the end of May 2020, there were already a number of well-known retailers and restaurant chains that filed for bankruptcy, with the vast majority of those filings occurring between March and May 2020. These include Tuesday Morning, J. Crew, Pier 1, Modell's Sporting Goods, True Religion, Lucky's Market, Earth Fare, Neiman Marcus, John Varvatos and others. *See* Business Insider, *These 16 Retailers and Restaurant Chains Have Filed for Bankruptcy or Liquidation in 2020* (June 1, 2020); *see also J.Crew, Neiman Marcus, and Others Are Filing For Bankruptcy. What Does That Mean, Exactly?* (May 12, 2020).

3 *See e.g.* Business Insider, *Dean Foods Receives Court Approval for the Sale of Substantially All of Its Assets* (Apr. 4, 2020); Construction Dive, *Judge Approves McDermott Reorganization, $2.7B Sale of Lummus Technology* (Mar. 13, 2020); Reuters, *U.S. Bankruptcy Court Approves $220 Million Sale of Shale Firm Alta Mesa* (Apr. 2020); The Real Deal, *Costar Acquires Troubled Rental Listings Firm for $588M* (Feb. 12, 2020).

In other cases, typically where a company has not identified an agreed-upon buyer prior to its bankruptcy filing, the company (now a debtor in bankruptcy) instead seeks approval of bid procedures without an identified stalking horse bidder and attempts to use the process of soliciting bids as a way to find a potential buyer during the bankruptcy.

In either case—that is, with a stalking horse bidder or simply the debtor seeking to establish bid procedures separately during the bankruptcy case, upon receipt of the bankruptcy court's approval of the bid procedures—the debtor can conduct the auction process to ascertain if there are any qualified bidders or any qualified competing bidders, as applicable, and to the extent any such bidders are identified, conduct an auction to determine the ultimate winning bidder. Once the winning bidder has been determined, the actual sale of the assets is submitted to the bankruptcy court for approval, and subject to receipt of the bankruptcy court's approval (and any closing conditions in the PSA), the sale may be consummated.

Some benefits of an acquisition of assets pursuant to a section 363 sale in bankruptcy include:

- Speed—potential for 60-90 days to closing;
- Potential for lower transaction costs;
- Ability to "cherry pick" assets and liabilities to be assumed;
- Assets can generally be obtained free and clear of liens and claims;
- Restricted contracts can often be assumed and assigned to the buyer; and
- Buyer protections—including potential "break-up" fees, "expense reimbursements," ability to influence minimum overbid amount and other terms of the bidding procedures.

Plan of Reorganization/Liquidation

In addition to acquiring the assets of a target company pursuant to a section 363 sale, an interested buyer may seek a sale-process effectuated under a confirmed plan of reorganization or liquidation. In this context, the target company/debtor proposes a plan pursuant to which the debtor agrees to sell the designated assets, subject to the assumption of agreed upon liabilities, to an identified buyer pursuant to a section 363-like process that is incorporated into the plan; that is, such sale is subject to the debtor's receipt of higher and better offers from third parties, which could be solicited pursuant to bidding procedures implemented in connection with the plan.

Although a sale of assets in connection with a plan is like a section 363 sale in that the buyer ultimately acquires the designated assets generally free and clear of liens and claims, subject only to the agreed upon assumed liabilities, because the sale is implemented in connection with the plan process it may be subject to all of the uncertainties, time delays, procedural requirements and impediments that are generally inherent in the plan process. For these reasons, the acquisition of assets by means of a sale process implemented in connection with a plan is generally utilized only where agreement has been reached among the debtor and its key creditor constituencies prior to the commencement of the bankruptcy proceedings regarding the sale of the debtor's assets. In this context, the plan is effectively "pre-packaged" or "pre-negotiated" by the debtor with its key creditor constituencies in order to avoid any unforeseen circumstances or time delays.

Generally, the benefits of acquiring assets pursuant to a "pre-packaged" or "pre-negotiated" plan include:

- Major stakeholders have agreed on critical terms prior to the filing;
- Assets can generally be transferred free and clear of encumbrances and interests;
- Restricted contracts can often be transferred;
- Transfer tax exemption under Section 1146(a) of the Bankruptcy Code;
- Potentially shortens and simplifies the bankruptcy process;
- With respect to a "pre-packaged" plan, votes for the plan have often already been solicited and approval received prior to the filing;
- Parties' interests more likely aligned, facilitating bankruptcy court approval of the plan and the documentation of the sale transaction; and
- Once filed, the bankruptcy generally proceeds fairly quickly.

Antitrust Considerations in Bankruptcy-Related Transactions

Hart-Scott-Rodino Act (HSR) Filings Can Have Accelerated Waiting Periods in Bankruptcy, but Not Always

Acquisitions of voting securities or assets above the annually adjusted thresholds,[4] including those made during a bankruptcy process, require notification under the HSR Act.[5] Under the HSR Act, parties typically must wait to close a transaction until they have observed the 30-day waiting period from the date both parties made their HSR notification with the DOJ and FTC. And, that waiting period may be extended if the antitrust authorities determine they need to investigate the

[4] The current lowest size-of-transaction threshold is $94 million. All current thresholds can be found at https://www.govinfo.gov/content/pkg/FR-2020-01-28/pdf/2020-01423.pdf.

[5] 15 U.S.C. 18a.

transaction further.[6] Even if the transaction does not meet the filing thresholds, the antitrust authorities may investigate the transaction and go to court to seek to block the closing.

For transactions covered by section 363(b) of the Bankruptcy Code, there is a shortened waiting period of only 15 days from the day both parties made their notifications under the HSR Act.[7] This means sales pursuant to section 363 of the Bankruptcy Code can receive a shorter waiting period; however, all other bankruptcy transactions subject to the HSR Act fall within the typical 30-day waiting period and do not receive an abbreviated waiting period.

Antitrust Review of Bankruptcy or Distressed Deals Proceed as Normal, but Parties May Have a Good Failing Firm Defense

The US antitrust authorities review bankruptcy related transactions in the same manner as they would any other transaction—by assessing whether the transaction would substantially lessen competition.[8] This is the case for both HSR reportable transactions, as well as transactions that do not trigger a filing requirement under the HSR Act. And, both the FTC[9] and DOJ[10] have made clear that the COVID-19 pandemic has not changed that approach.[11]

When the target is distressed, or even entering bankruptcy proceedings, there is a logical argument that its competitive significance has been reduced. The antitrust authorities, however, seek to maintain whatever competitive pressure remains and preserve the potential for such targets to become more competitive in the future where possible. As a result, it is not atypical for the authorities to investigate and even challenge transactions made out of bankruptcy—particularly when the parties are competitors

For instance, in November 2019, Dean Food's filed for Chapter 11 bankruptcy, and in March 2020, pursuant to bidding procedures entered in the bankruptcy proceeding, Dean Food's selected Diary Farmers of America, Inc. (DFA) as its winning bidder for the majority of its assets.[12] In May 2020, the DOJ Antitrust Division, together with the Massachusetts and Wisconsin attorneys general, filed a lawsuit in the District Court for the Northern District of Illinois to prevent the sale on antitrust grounds.[13] Simultaneously with the filing of the complaint, the parties entered into a settlement requiring the divestiture of certain milk processing plants to alleviate the competition concerns with the proposed transaction.[14]

Similarly, in June 2020 real estate information service provider, CoStar, received bankruptcy court approval to buy Rentpath pursuant to the confirmation of Rentpath and its affiliated debtors joint Chapter 11 plan (with the sale transaction incorporated into the terms of the plan). In April 2020, CoStar reported that the FTC had issued a Second Request and opened an investigation into the competitive effects of the proposed transaction.[15] The transaction still has not closed as of this publication.

And in a number of instances, after a thorough investigation, the authorities may believe the transaction out of bankruptcy will substantially lessen competition and seek to litigate. For example, while the case was ultimately settled, DOJ sued to block US Airways' acquisition of American out of bankruptcy in 2013.[16] In 2001, the DOJ also litigated to enjoin a proposed SunGard's acquisition of Comdisco out of bankruptcy.[17] The bankruptcy court had approved SunGard, a competitor to Comdisco as the winning bidder. DOJ challenged the transaction on the grounds that it would substantially lessen competition for disaster recovery services. DOJ ultimately lost its bid to enjoin the transaction, but it demonstrates that the antitrust authorities may challenge transactions even when a target has entered bankruptcy.

However, the antitrust authorities will consider the competitive standing of a company that is in bankruptcy or how COVID may be reshaping certain market conditions. These are important considerations that the antitrust authorities will evaluate. In fact, courts and the antitrust authorities have recognized that in certain circumstances a "failing firm" defense is valid and a complete defense to potential antitrust concerns. In short, if it is so obvious that the assets will otherwise exit the market, it alleviates the potential competitive concerns with the transaction.

6 16 CFR 803.10(b).

7 16 CFR 803.10(b) (providing for a 15-day waiting period for an acquisition covered by 11 U.S.C. 363(b)). HSR guidance also provides for the filing by multiple bidders to file on a court's order but clarifies that "it's only a 363(b) filing that gets the shortened waiting period." *See* FTC Informal Interpretation #1307002.

8 *See* 15 U.S.C. 18.

9 FTC stated it would "not suspend {its} usual rigorous approach" even though it was "navigat{ing} uncharted waters" and working remotely. FTC, Antitrust review at the FTC: staying the course during uncertain times (Apr. 6, 2020).

10 DOJ made similar statements that while it will cooperate with parties in navigating process changes made due to COVID, it will still act consistently with its responsibilities under the antitrust laws. DOJ, *Justice Department Announces Antitrust Civil Process Changes for Pendency of COVID-19 Event* (March 17, 2020).

11 This continued rigor by the antitrust authorities impacts not only the review of acquisitions, but also the review of potential buyers of any divestitures to be made to resolve competitive concerns with a transaction. As a result, divestiture buyers should be even more prepared to explain their ability to finance the acquisition and rationale for buying the assets, provide business plans, and make personnel from the buyer and its financing sources available.

12 Complaint, *United States v. Dairy Farmers of Am.*, 20-cv-02658 (May 1, 2020).

13 *Id.*

14 Proposed Final Judgment, *United States v. Dairy Farmers of Am.*, 20-cv-02658 (N.D. Ill. May 1, 2020).

15 CoStar Group Form 8-K April 30, 2020.

16 Complaint, *United States v. US Airways Group, Inc.,*13-cv-01236 (D.D.C. Aug. 13, 2013).

17 Complaint, *United States v. Sungard Data Systems, Inc.*, 01-2196 (D.D.C. Oct. 22, 2001).

To use this defense, however, a buyer must demonstrate not just that the target is merely in distress or that bankruptcy may be imminent. Rather, the defense will only be accepted in a narrower set of circumstances.

Guidance the DOJ and FTC have issued is instructive.[18] The antitrust authorities require the following to establish the defense:

- Evidence that the allegedly failing firm is not able to meet its financial obligations in the near future or reorganize successfully under Chapter 11 of the Bankruptcy Code;
- Evidence the failing firm "made unsuccessful good-faith efforts to elicit reasonable alternative offers that would keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger;"[19] and
- To the extent there were other offers, evidence that it rejected other suitors for good reasons, in good faith, or had no alternative buyers from which to choose.

Often, when the parties cannot demonstrate the narrow circumstances of the failing firm defense, they may attempt to argue that the distressed or "flailing firm" nature of the target is relevant to the analysis of potential competitive effects. However, this alone is typically not likely to be sufficient to resolve competition concerns. For example, in *Promedica Health Sys. v. FTC*, the Court called the defense the "the Hail–Mary pass of presumptively doomed mergers." *Promedica Health Sys., Inc. v. Fed. Trade Comm'n*, 749 F.3d 559, 572 (6th Cir. 2014).

As such, parties anticipating that they will advance arguments about the target being in distress still should be prepared to engage in an in-depth factual analysis and advocacy as they would in other merger circumstances.

Key Takeaways

- ❖ Parties involved in bankruptcy transactions need to consider (1) whether there is a requirement to file under the HSR Act, and (2) whether the transaction raises any substantive antitrust concerns that might be investigated and delay closing.
- ❖ Buyers that pose significant antitrust issues or risks, may not represent the "highest and otherwise best" offer to be selected as the "winning bidder" in a bankruptcy auction, despite having the highest purchase price because their ability and timeline to get to closing may be in question.
- ❖ If buyers that pose some substantive antitrust risk want to have a realistic risk of closing on the quicker timelines of a bankruptcy or distressed sale, they should invest upfront and develop a strategy to (1) convince the seller that the risk is manageable, (2) convince the other stakeholders in the bankruptcy and/or the bankruptcy court that the antitrust issues will not be an obstacle to closing, and (3) convince the antitrust authorities that the transaction does not raise significant concerns (including by potentially offering divestiture remedies and an upfront buyer ready if needed).
- ❖ Parties to smaller transactions must still be cognizant of the potential antitrust issues that may arise, even if the transaction is not reportable under HSR Act. The US antitrust authorities can—and do—investigate non-reportable transactions

[18] Dep't of Justice & FTC, Horizontal Merger Guidelines § 11 (Aug. 19, 2020).

[19] *Id.* Examples of good-faith efforts to elicit reasonable alternative offers can include: (1) hiring investment bankers or search consultants; (2) publicizing the sale; (3) formulating a detailed and thorough proposal process; (4) seeking out a number of potential partners; or, (5) a bankruptcy auction.

Continued from p.23

that raise substantial issues when they are aware of such transactions. In fact, due to the public nature of the bankruptcy proceedings and related press coverage, the antitrust authorities are likely to be aware of the transaction even without having to be notified about it. Therefore, they will have the opportunity to investigate—and even potentially intervene in the bankruptcy proceeding—if there are substantive antitrust concerns that they believe merit an investigation.

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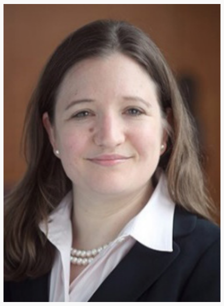

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