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BANKRUPTCY JUDGE FINDS NO COLLUSION IN GRAND UNION AUCTION

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On November 30, 2000, the Bankruptcy Court for the District of New Jersey overruled the objection of the Great Atlantic & Pacific Tea Company ("A&P") to the auction of substantially all of the assets of the Grand Union Company ("Grand Union") to C&S Wholesale Grocers, Inc. ("C&S") in Grand Union's chapter 11 case. A&P asserted that C&S colluded with several other retail supermarket chains in violation of section 363(n) of the Bankruptcy Code by submitting a joint bid which, A&P maintained, ensured that no other bidder (here A&P) could acquire the stores at issue, and which depressed the sale price. A&P also claimed that such alleged collusive activity violated federal antitrust laws. In overruling A&P's objection, the Bankruptcy Court expressly adopted the reasoning of the Second Circuit in In re New York Trap Rock Corp. v. Compania Naviera Perez Companc, S.A. 42 F.3d 747 (2d Cir. 1994), and held that joint bids are not collusive when (i) they are disclosed to the debtor and other constituencies and (ii) the conduct in question does not depress the price paid at the auction.

Background

Before its sale to C&S, Grand Union operated 197 retail food stores in five northeastern states. On October 3, 2000, Grand Union filed a petition for relief under chapter 11 of the Bankruptcy Code. Before its chapter 11 filing, Grand Union was involved in discussions and negotiations with C&S, as well as Grand Union's lenders, regarding a possible sale. As a wholesale distributor and Grand Union's largest unsecured creditor, C&S was concerned about retaining a market for its goods. Thus, C&S and Grand Union envisioned a sale whereby C&S would purchase Grand Union stores in conjunction with other retail grocers.

Grand Union and C&S entered into an asset purchase agreement that served as the "Stalking Horse" bid for a Bankruptcy Court supervised auction. C&S submitted a bid on behalf of itself and a group of other supermarket retailers to acquire substantially all of Grand Union's stores in

one sale. The structure of the Stalking Horse bid — including the fact that it was being made on behalf of C&S and several supermarket retailers — was disclosed to all parties in interest, including the Bankruptcy Court, the United States Trustee, the Creditors' Committee, Grand Union's principal secured lender, Grand Union and other potential bidders. Under the terms of the auction procedures which were approved by the Bankruptcy Court, potential purchasers could bid either on individual stores or in bulk for all or substantially all of the assets. If bids aggregated to more than 105% of the Stalking Horse bid, they would be considered winning bids. As part of this procedure, A&P made an initial bid of $70 million for 12 Grand Union stores.

The Auction

On November 16, 2000, Grand Union began the auction. Several parties submitted bids for individual stores and groups of stores. A&P resubmitted its bid of $70 million for 12 stores and also made individual bids on other stores. At the conclusion of the auction, Grand Union compared the bids submitted at the auction to the "Stalking Horse" bid submitted by C&S. Grand Union concluded that the individual bids did not exceed the "Stalking Horse" bid, and thus found the C&S offer to be the highest and best offer.

The Objection

A&P objected to the auction on two grounds: (i) that the proposed sale to C&S resulted from collusion among C&S and the participants in the joint bid and (ii) that the proposed sale violated antitrust laws. A&P requested that the Bankruptcy Court deny Grand Union's motion to approve the sale and instead order a new auction in which C&S could not participate.

Specifically, A&P contended that section 363(n) of the Bankruptcy Code permits a debtor[1] to "avoid a sale under this section if the sale price was controlled by an agreement among

[1] C&S argued that, because section 363(n) refers to avoidance actions by a "debtor,"A&P had no standing to object. The Bankruptcy Court interpreted A&P's objection as one directed at the

potential bidders at such sale." A&P argued that because the auction provided for bids on individual stores or groups of stores, the absence of individual bids from Stop & Shop, Pathmark and other retailers evidenced an intent on the part of C&S and those merchants to control the auction under the guise of the "Stalking Horse" bid.

A&P charged that in orchestrating this alleged bid-rigging scheme, C&S failed to act as a good faith purchaser. Under Third Circuit precedent, collusion between a purchaser and other bidders invalidates a purchaser's good faith status. In re Abbots Dairies of Pennsylvania, Inc., 788 F.2d 143, 149-50 (3d Cir. 1986). Thus, A&P submitted, the Bankruptcy Court had the responsibility to invalidate C&S's bid and preclude it from participating in a new auction.

A&P argued additionally that C&S's conduct constituted a per se violation of the Sherman Act. A&P accused C&S of conducting two separate auctions: (i) the public auction conducted under the auspices of the Bankruptcy Court, in which major supermarket chains agreed not to participate, and (ii) a private, secret auction in which C&S and the same non-bidding retailers bid on Grand Union's assets. According to A&P, C&S's characterization of its bid as a joint one between it and other retailers was an after-the-fact attempt to disguise C&S's illegal private conduct.

The Hearing

In response to A&P's objection, Grand Union and C&S raised two related defenses. First, they asserted that section 363(n) of the Bankruptcy Code proscribes only secret agreements to control the purchase price of a debtor's assets. Second, they noted that such secret agreements must depress the price paid for the debtor's assets for them to violate section 363(n). Neither of these fact patterns applied, they maintained: C&S and Grand Union had disclosed the C&S collaborative bid to key parties in interest, including A&P. Further, they argued, the joint bidding arrangement actually increased the purchase price.

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1 cont. auction procedures and not the price paid. The Bankruptcy Court observed that it was axiomatic that unsuccessful bidders always had standing to challenge an auction's procedures.

Grand Union also countered A&P's claims by relying on a line of cases that hold that disclosure, especially to a debtor, militates against the risk of collusion. With full disclosure, the debtor's acceptance or rejection of a joint bid is an exercise of business judgment, not subject to second-guessing by a court or an unsuccessful bidder. Moreover, Grand Union and C&S asserted that only secret arrangements sprung on the debtor as a last minute fait accompli qualify as collusive. Here, the record indicated that Grand Union and C&S were involved in discussions and negotiations about a joint bid before the chapter 11 filing. Under these circumstances, A&P faced a heavy burden to prove collusion on the part of C&S and its joint bidders.

The Creditors' Committee, the bank group, composed of Grand Union's prepetition lenders, and the United States Trustee all supported the auction result and urged that A&P's objection be overruled. The Creditors' Committee emphasized that the Court approved auction procedures were identical to those employed in numerous retail liquidations. The Committee also noted that joint bids are the rule rather than the exception. Such arrangements increase efficiency and make it more likely to dispose of assets in an orderly, as opposed to a piecemeal, process.

In urging approval of the sale, the Bank Group noted that it was "their" collateral at stake, and that the structure of the auction maximized their return. A single bid that disposed of substantially all the assets as a going concern, the Bank Group contended, would best serve the lenders' interests in an orderly and efficient liquidation process.

Finally, The United States Trustee urged the Bankruptcy Court to adopt the standard enunciated by the Second Circuit in In re New York Trap Rock Corp. v. Compania Naviera Perez Companc, S.A. 42 F.3d at 752. In Trap Rock, the Second Circuit considered an auction at which potentially collusive activity may have affected the final sale price. The debtors argued that this "effect" implicated section 363(n) of the Bankruptcy Code and provided grounds for avoiding the sale. The Court of Appeals disagreed, noting that section 363(n) provided a remedy only if an

agreement among potential bidders "controlled" the sale price. The Court reasoned that "control" of the sales price requires the exercise of a restraining or directing influence over it; thus, only those agreements that serve to depress the price received at an auction implicate section 363(n). In addition, the Second Circuit held that the bidders might be liable for fraud on the court if they secretly withheld their agreement. Id. In contrast, C&S argued it had made adequate disclosure of its joint bid.

The Decision

After considering the arguments of counsel, testimony in the form of affidavits and depositions and cross-examination thereon, Bankruptcy Judge Novalyn Winfield held that A&P's objection, although made in good faith, had no legal substance. The Court made its decision on both factual and legal grounds.

Judge Winfield first observed that Grand Union's chapter 11 filing amounted to a plan of liquidation. She noted that pre-petition marketing of Grand Union had not produced a purchaser. Further, Grand Union had invited C&S to bid on its assets. In addition, C&S's bid was not exclusive nor concealed from any relevant parties. Finally, she agreed that such joint bids were standard in the industry, especially when one considered the size of the transaction contemplated here.

The Bankruptcy Court underscored the importance of disclosure by noting that Grand Union's prepetition lenders were aware of the negotiations between Grand Union and C&S months before the chapter 11 filing. Judge Winfield also noted that Grand Union had properly exercised its business judgment in concluding that the both the structure and price of the C&S bid were in the debtor's best interests. Grand Union had very little time to effect a sale, given the constraints imposed by its lenders and the unavailability of additional credit. Time, according to the Court, was of the essence when one considered the relative unattractiveness of Grand Union's assets and its dwindling cash. As a final point, Judge Winfield noted that both the Creditors' Committee and the Bank Group supported the C&S sale, and that the US Trustee had not objected to the transaction.

In rendering her decision, Judge Winfield expressly adopted the collusion standard enunciated in New York Trap Rock. She held that only those agreements that are (i) undisclosed and (ii) have a negative impact on price implicate section 363(n) of the Bankruptcy Code. That the term sheets did not expressly refer to joint bids was immaterial; it was common knowledge, according to the Bankruptcy Court, that C&S intended to make a joint bid for Grand Union's assets.[2] Grand Union's awareness and encouragement of this type of bidding further cut against any finding of secrecy. Moreover, the Bankruptcy Court found that the only evidence before the Court suggested that the joint bidding mechanism used here served to increase the price received by Grand Union; the C&S bid allowed Grand Union to dispose of substantially all of its stores in a single transaction with a lowered risk of regulatory hurdles blocking the deal. Both of these factors, the Bankruptcy Court noted, benefited Grand Union and its creditors.

For all of these reasons, Judge Winfield also concluded that C&S was not involved in bid-rigging or conspiracy within the meaning of the anti-trust statutes.

Conclusion

The decision of the Bankruptcy Court for the District of New Jersey in In re Grand Union, sustains the practice of soliciting joint "Stalking Horse" bids in auctions conducted pursuant to section 363 of the Bankruptcy Code. In rejecting an unsuccessful bidder's charges of collusion, the Bankruptcy Court expressly adopted the standard set by the Second Circuit Court of Appeals: joint bids are collusive only if (i) they are undisclosed to the debtor and other parties in interest and (ii) serve to depress the price received for the assets at the auction.

[2] It should be noted, however, that the individual allocations among the joint bidders, were not disclosed. Moreover, it was not disclosed whether the members of the C&S consortium had bound themselves not to bid separately on the assets or not to join with other bidders other than C&S.

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This memorandum provides only a general overview. It is not intended to provide legal advice, and no legal or business decision should be based on its contents.

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