

COLLUSION CONFUSION: WHERE DO COURTS DRAW THE LINES IN APPLYING BANKRUPTCY CODE SECTION 363(N)?

Jason Binford*

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* Jason Binford is an associate with Haynes and Boone, LLP practicing in business reorganization. He graduated cum laude from St. Mary's University School of Law in 2004 where he was Editor-in-Chief of the *St. Mary's Law Journal*.

INTRODUCTION

Recent changes, statutory and otherwise, have caused fundamental shifts in the practice of corporate bankruptcy law. Until recently, an unprecedented amount of liquidity permitted financially distressed companies to prop themselves up with infusions of capital. While the credit markets have tightened,¹ the effects of the era of “easy money” will continue to be felt for quite some time. Moreover, when companies do file for bankruptcy, debtors often find that they must deal with hedge funds, as opposed to traditional banks, because such funds have replaced banks as the principal lenders to many distressed companies.² The participation of these funds can greatly complicate a bankruptcy case. For example, hedge funds often take aggressive positions and are much less reluctant than a bank to attempt to wrestle control of the company away from the debtor.³ The financial industry, already in flux as a result of these market changes, was further affected by the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).⁴ Much of the initial commentary surrounding BAPCPA

¹ Chris Files, *Credit Squeeze Leaves Long Shadow*, FIN. TIMES, Oct. 17, 2007, at 1.

² Bernard Wysocki, Jr., *For Troubled Firms, a Flood of Big Loans*, WALL ST. J., June 12, 2007, at A1 (discussing the fact that the financial industry is awash in “rescue financing” loans and that the face value of outstanding leveraged loans has sky-rocketed in the last ten years).

³ See Bernard Wysocki, Jr., *Lending a Hand: New Breed of Hardball Investors Makes Loans, Takes Control*, WALL ST. J., Dec. 12, 2006, at A1 (discussing the “loan to own” economic model and writing: “Hedge funds and private-equity firms, groups that control billions in investments, have piled into distressed debt and high-risk loans to troubled companies. But unlike traditional banks, which often have little alternative to seeking repayment, these new players are often quite willing to take over if things go sour.”). This Article was the ninth, and final, in a series of articles published by the Wall Street Journal over the second half of 2006 titled “Private Money: The New Financial Order.” The series provided insight into how the flood of private equity funds has transformed the finance industry. See Greg Ip & Henny Sender, *Cash Machine: In Today’s Buyouts, Payday for Firms is Never Far Away*, WALL ST. J., July 25, 2006, at A1 (part one); Henny Sender & Anita Raghavan, *Worry Amid Hedge Fund Boom: Privileged Access to Information*, WALL ST. J., July 27, 2006, at A1 (part two); Jason Singer, *Raising the Stakes: In Twist for Private Buyouts, Some Shareholders Fight Back*, WALL ST. J., Aug. 18, 2006, at A1 (part three); Susan Pulliam, *The Hedge-Fund King is Getting Nervous*, WALL ST. J., Sept. 16, 2006, at A1 (part four); Ann Davis, *Blue Flameout: How Giant Bets on Natural Gas Sank Brash Hedge-Fund Trader*, WALL ST. J., Sept. 19, 2006, at A1 (part five); Ianthe Jeanne Dugan, *Repair Job: Billionaire Investor Drives Overhaul of Auto-Parts Giant*, WALL ST. J., Sept. 30, 2006, at A1 (part six); Laurie P. Cohen, *In the Know: Seeking an Edge, Big Investors Turn to Network of Informants*, WALL ST. J., Nov. 27, 2006, at A1 (part seven); Brody Mullins & Kara Scannell, *Hedge Funds Hire Lobbyists to Gather Tips in Washington*, WALL ST. J., Dec. 8, 2006, at A1 (part eight).

⁴ Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

concerned its effects on consumer bankruptcy filings,⁵ but the act also made substantial changes to the Bankruptcy Code that have reverberated in the corporate bankruptcy world. While the influx of easy capital and the complication of the bankruptcy process have contributed to the low number of corporate bankruptcy filings, the changes in the bankruptcy law have also played a part.⁶ These changes have made reorganization via the bankruptcy courts more expensive and otherwise generally less attractive.⁷ As a result, large corporate bankruptcy filings are at a ten-year low.⁸

None of this is to say, however, that the practice of corporate bankruptcy has come to an end. The Bankruptcy Code continues to offer solutions that are simply unavailable in other workout scenarios. Rather than avoid the bankruptcy courts altogether, bankruptcy practitioners and commentators predict that companies will make more frequent use of remedies that are short of a traditional reorganization. One example is the sale of a business (or portion of a business) pursuant to § 363 of the Bankruptcy Code⁹.

Section 363 allows a debtor¹⁰ to sell assets outside the ordinary course of business. The section can be used for the sale of any of the debtor's assets, but the term "363 sale" (also known as a "going concern sale") usually refers to a sale of the debtor's entire business via a public or private auction process. A common procedure¹¹ involves a debtor seeking an initial bid on the assets from a "stalking horse bidder." The debtor will then request that the court approve

⁵ See, e.g., Peter C. Alexander, "Herstory" Repeats: *The Bankruptcy Code Harms Women and Children*, 13 AM. BANKR. INST. L. REV. 571 (2005) (arguing that the changes under BAPCPA made an already inequitable Bankruptcy Code even worse for consumers).

⁶ Some companies, such as Delphi Corporation, timed their Chapter 11 filings to avoid the application of the BAPCPA. See Constance Mitchell-Ford, *A New Chapter 11 for Companies*, WALL ST. J., Oct. 15, 2005, at A2 (quoting Delphi chief executive Steve Miller as saying he did not want his company "to be a guinea pig" under the new law).

⁷ See Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603, 603 (2005) ("The bill's business bankruptcy provisions, many of which are poorly drafted, make substantial changes to Chapter 11 reorganization law, changes that, for the most part, will adversely affect the ability of businesses to reorganize."); see also Steve H. Nickles, *Behavioral Effect of New Bankruptcy Law on Management and Lawyers: Collage of Recent Statutes and Cases Discouraging Chapter 11 Bankruptcy*, 59 ARK. L. REV. 329 (2006).

⁸ Bernard Wysocki, Jr., *Lending a Hand: For Troubled Firms, a Flood of Big Loans*, WALL ST. J., June 12, 2007, at A1.

⁹ 11 U.S.C. § 363(n) (2000).

¹⁰ The term "debtor" is used in this Article to refer to a debtor in possession holding the rights of a trustee pursuant to 11 U.S.C. § 1107(a).

¹¹ For a more extensive discussion of § 363 sale procedures, see generally Michael B. Solow & Harold D. Israel, *Buying Assets in Bankruptcy: A Guide to Purchasers*, 10 J. BANKR. L. & PRAC. 87 (2000).

bid procedures and marketing efforts. When using a stalking horse bidder, such bid procedures will often involve a “breakup fee” paid to the stalking horse bidder, if it is outbid, to compensate for the expense of conducting the due diligence necessary to set the first bid. Once the auction is completed, the debtor will take the highest and best bid and will seek court authorization to sell the assets to the winning bidder. At this point, the court will hear any objections to the sale made by other parties in interest. Once the court issues an order approving the sale, § 363(m) provides that the sale can be overturned only upon a showing that the purchaser lacked “good faith.”¹²

Because § 363 sales do not involve the lengthy and expensive process of, for example, soliciting votes in favor of a plan or reorganization, such sales are an attractive alternative to selling a business pursuant to the terms of a court-confirmed plan of reorganization.¹³ Moreover, the use of such sales has increased in popularity in recent years.¹⁴ Given this increased use of § 363 sales, and given the increased number of participants in the bankruptcy process, it is more important than ever that the debtor and bidders alike know the rules of the game. No such rule is more important than the prohibition of collusive bidding as set forth in Bankruptcy Code § 363(n). Section 363(n) is relatively short and straightforward. The section reads, in its entirety:

The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys’ fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court

¹² See discussion *infra* Part II.B. Also note that sale orders often contain a finding by the court that the purchaser acted in good faith. In fact, the leading case discussing § 363(m) holds that a court *must* make such a finding when approving a sale. See *In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143, 149–50 (3d Cir. 1986).

¹³ Courts will not, however, always permit a debtor to sell its assets via a § 363 sale, as opposed to a sale pursuant to the terms of a confirmed plan of reorganization. Upon scrutiny, a court may determine that a proposed § 363 sale is, in fact, an impermissible “sub rosa” plan of reorganization. See generally Craig A. Sloane, *The Sub Rosa Plan of Reorganization: Side-Stepping Creditor Protections in Chapter 11*, 16 BANKR. DEV. J. 37 (1999); Elizabeth B. Rose, Comment, *Chocolate, Flowers, and § 363(b): The Opportunity for Sweetheart Deals Without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249 (2006).

¹⁴ See Andrew M. Thau et al., *Postconfirmation Liquidation Vehicles (Including Liquidating Trusts and Postconfirmation Estates): An Overview*, 16 J. BANKR. L. & PRAC. 201 (2007) (noting the “growing trend” of § 363 sales); see also *Do 363 Sales Maximize Value?*, 48 BANKRUPTCY COURT DECISIONS WEEKLY NEWS & COMMENT 4, at p. 4 (May 15, 2007) (discussing a forthcoming study by Professor Lynn LoPucki showing that, while § 363 sales are popular, a reorganization pursuant to a plan of reorganization may provide creditors with a much larger recovery).

may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

Although the word “collusion” is never actually used, § 363(n) is universally understood to prohibit collusion among potential bidders at a § 363 sale. The text of § 363(n) makes no effort to explain what is, and what is not, considered collusion. Congress left it to the courts to clarify this issue. The importance of understanding the boundaries set out in § 363(n) is illustrated by the consequences of violating the section. These include the setting aside of the sale, monetary damages (including punitive damages), and criminal prosecution.¹⁵

Very little has been written about collusion in bankruptcy sales in general or § 363(n) specifically.¹⁶ Moreover, there is not a large body of § 363(n) case law. This Article summarizes the issues raised in the case law in an attempt to provide some guidance to participants in § 363 sales. Part I discusses the legislative history of § 363(n). Part II analyzes the elements that must be shown for a party to be liable under § 363(n) and the case law discussing its application. Part II also discusses the consequences of violating § 363(n). Finally, Part III discusses the body of case law dealing with the finality of sale orders and whether § 363(n) is an exception to otherwise applicable statutes of limitation. While a discussion of all these issues does not provide a crystal clear roadmap to avoiding liability, it should allow a party to recognize the principal signposts along the way.

I. THE LEGISLATIVE HISTORY OF § 363(N)

There is not a great deal of legislative history for § 363(n). In fact, the lack of discussion at the time of enactment, and the lack of amendments since enactment, is at least as significant as what Congress did say when it was enacted. Congress enacted § 363(n) as part of the Bankruptcy Reform Act of

¹⁵ See discussion *infra* Part II.B.3.

¹⁶ The only article exclusively on the topic of § 363(n) appears to be John J. Rapisardi, *Collusive Bidding Under the Bankruptcy Code*, N.Y. L. J., April 4, 1995, at 1. Other articles discuss the section briefly. See, e.g., C.R. Bowles & John Egan, *The Sale of the Century or a Fraud on Creditors?: The Fiduciary Duty of Trustees and Debtors in Possession Relating to the “Sale” of a Debtor’s Assets in Bankruptcy*, 28 U. MEM. L. REV. 781, 830–36 (1998); Janet A. Flaccus, *To Disclose or Not Disclose: Bankruptcy Crimes and Pats on the Back*, 8 J. BANKR. L. & PRAC. 301, 331–40 (1999); Solow & Israel, *supra* note 11, at 104–06; James H.M. Sprayregen & Jonathan Friedland, *The Legal Considerations of Acquiring Distressed Businesses: A Primer*, 11 J. BANKR. L. & PRAC. 3, 16–17 (2001).

1978 (the “Reform Act”). Prior to the enactment of the Reform Act, bankruptcy law was governed by the Bankruptcy Act of 1898 (the “Act”).¹⁷ Section 70(f) of the Act allowed for the sale of a debtor’s real or personal property, conditioned on the bankruptcy court’s approval. No mention was made of agreements among bidders or of the purchaser’s good faith. While bankruptcy law did not yet provide these protections, section 70(f) did work to ensure that the property was not sold for an unreasonably low price by requiring that the property “shall not be sold otherwise than subject to the approval of the court for less than 75 per centum of its appraised value.”¹⁸ Some courts have continued to apply this doctrine under the current Bankruptcy Code.¹⁹

The Act was the first successful federal bankruptcy statute and governed the application of bankruptcy law for almost eighty years. A significant rise in bankruptcy filings in the 1960s, however, caught the attention of Congress.²⁰ It responded in 1970 by forming the Commission on the Bankruptcy Laws of the United States (the “Commission”).²¹ The Commission’s mission was very broad: “to study, analyze, evaluate, and recommend changes in the substance and administration of the bankruptcy laws of the United States.”²² The Commission issued its report in 1973, complete with substantive analysis of bankruptcy policy and a proposed new Bankruptcy Code.²³ The report laid the foundation for the modern § 363, but contained no reference to the good faith of a purchaser or to collusion.

Sections 363(m) and (n) resulted from a compromise between the recommendations of the Commission and the National Conference of Bankruptcy Judges (the “Conference”). The Commission did not include any

¹⁷ The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898).

¹⁸ *Id.* § 70(f).

¹⁹ *Licensing by Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.3d 380, 390 (2d Cir. 1997) (analyzing whether a party had purchased property in good faith and for value and noting that, “[g]enerally speaking, a purchaser who pays 75 percent of the appraised value of the assets has tendered value.”); *see also In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143, 149 (3d Cir. 1986); *In re Rock Indus. Mach. Corp.*, 572 F.2d 1195, 1197 n.1 (7th Cir. 1978).

²⁰ DAVID A. SKEEL, JR., *DEBT’S DOMINION* 131–32, 136 (2001) (“A sharp increase in bankruptcy filings [in the 1960s]—which pundits attributed to the rise of consumer credit, the diminished stigma of bankruptcy, or some combination of the two—focused increasing attention on the limitation of the existing bankruptcy process. . . . The reason for the sudden interest in bankruptcy was simple: bankruptcy filings had risen to previously unheard-of levels, and each year seemed to bring a new record.”).

²¹ Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 *DEPAUL L. REV.* 941, 942–43 (1978).

²² *Id.* at 943.

²³ SKEEL, *supra* note 20, at 139.

bankruptcy judges, then known as “referees,” as members.²⁴ After being excluded from directly participating in such a historic change to the bankruptcy law,²⁵ the Conference submitted its own competing bankruptcy bill to Congress in 1974 (known as the “Judges’ Bill”).²⁶ The Judges’ Bill contained the provisions that eventually became § 363(n).²⁷ The Commission, however, continued to assert that this addition was unnecessary. Specifically, in the hearings on the Commission’s bill, the representative of the Commission expressed its concern over the addition of § 363(n), testifying that the issue was better left to the courts and that the broad language of the statute could cover legitimate efforts by two parties to enter into an agreement to purchase the debtor’s property.²⁸

²⁴ SKEEL, *supra* note 20, at 138–39. According to Skeel, the bankruptcy judges were black-balled from the Commission by federal district and circuit judges who generally looked down on the bankruptcy referees. “Chief Justice Burger shared the district judges’ concerns about diluting the federal bench and about the inferior quality of many bankruptcy judges.” *Id.*

²⁵ “Furious at their exclusion from the commission, the bankruptcy judges responded with the equivalent of the Salon des Refusés from art history lore. When Monet, Manet, and the early impressionists were rejected by the fashionable Paris Salon, they set up their own exhibition, which they called the Salon des Refusés. It stood as a direct challenge to its more established predecessor and has long been seen as a defining moment in the early history of impressionism.” *Id.* at 139.

²⁶ Klee, *supra* note 21, at 944–45.

²⁷ A likely motivation behind adding provisions requiring good faith and prohibiting collusion was to allay the perception that bankruptcy law was practiced by a shady group of insiders known as the “bankruptcy ring.” Routine instances of conflicts of interest and outright conspiracy were laid bare earlier in investigations conducted in the 1920s and 1930s. See SKEEL, *supra* note 20, at 75–80 (noting the concern that a “bankruptcy ring” had fixed the bankruptcy process and discussing investigative reports issued by William Donovan and Thomas Thatcher). The debate leading to the modern Bankruptcy Code included concerns about the bankruptcy ring and the general state of bankruptcy practice. *Id.* at 138. As parties intimately involved in bankruptcy practice, the bankruptcy judges no doubt were concerned about the perception of the practice. This could help explain why they included explicit provisions designed to ensure that collusive deals were not permitted.

²⁸ *Bankruptcy Act Revision: Hearing on H.R. 31 Before the Subcomm. on Civil and Constitutional Rights of the H. Comm. on the Judiciary*, 98th Cong. 1837–38 (1978) (statement of Leon S. Forman, Member, National Bankruptcy Conference), BANKR78-LH8 (Westlaw Arnold & Porter LLP Legislative History). The representative testified:

The Judges’ Bill has added a new provision to this section for the purpose of prohibiting collusive bidding. [The Commission] considered this provision and found it unnecessary and recommends that it not be included. Collusive bidding is better left to the courts, as they have dealt with the subject adequately heretofore. The language of the proposed provision in the Judges’ Bill appears to be too broad and might well cover legitimate instances in which more than one person interested in property offered by the trustee for sale enter into an agreement to purchase the same jointly.

Id. Courts, in fact, continue to struggle with the issue of whether joint bidding is permissible collaboration or prohibited collusion. See discussion *infra* Part II.B.2.a.3.

This was only one of many differences between the competing bills. The final version of the Bankruptcy Code was enacted only after the Commission and the Conference were told that there would be no reform unless the two warring camps could resolve their differences.²⁹ Ultimately, the only mention of § 363(n) in the legislative history of what would become the Bankruptcy Code is the following text from a House and Senate report:

Subsection [n]³⁰ is directed at collusive bidding on property sold under this section. It permits the trustee to void a sale if the price of the sale was controlled by an agreement among potential bidders. The trustee may also recover the excess of the value of the property over the purchase price, and may recover any costs, attorney's fees or expenses incurred in voiding the sale or recovering the difference. In addition, the court is authorized to grant judgment in favor of the estate and against the collusive bidder if the agreement controlling the sale price was entered into in willful disregard to this subsection. The subsection does not specify the precise measure of damages, but simply provides for punitive damages, to be fixed in light of the circumstances.³¹

Aside from this short paragraph, Congress left little guidance to the courts in the application of § 363(n).

Section 363(n) has not been substantively revised since the enactment of the Reform Act.³² The recently-enacted BAPCPA included neither changes nor discussion of changes to § 363(n).³³ In addition, the National Bankruptcy Review Commission issued a report in 1997 with an overview of the state of

²⁹ SKEEL, *supra* note 20, at 140 (“As [bankruptcy attorney] Ron Trost recalls it, Representative [Don] Edwards, a member of the 1970 commission and the leading congressional advocate for reform, told the bankruptcy judges and National Bankruptcy Conference that there would be no reform unless they resolved their differences. The two groups then met in Atlanta and hammered out a series of compromises that gave rise to [the Bankruptcy Code].”).

³⁰ The actual quotation reads “Subsection (m).” The correct reading is “Subsection (n).” This typographical error is the result of the late addition of § 363(k) to the Reform Act. After the addition of this subsection, Congress neglected to re-letter the remainder of Section 363. See 8 WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW & PRACTICE 2D, at 390, 392–93 (West 2006).

³¹ H.R. REP. NO. 95-595, at 346 (1977), as reprinted in 1978 U.S.C.C.A.N. 5953, 6302–03; see also S. REP. NO. 95-989, at 57 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5843 (containing minor typographical variations).

³² NORTON, *supra* note 30, at 393 (noting that § 363(n) was amended by § 442(i) of the Bankruptcy Amendment Act of 1984 to correct typographical errors and make stylistic changes).

³³ The only change made to § 363 by the BAPCPA was the addition of the new § 363(o). *Id.*

bankruptcy law and with many suggested changes to the Bankruptcy Code.³⁴ This report did not suggest any changes to § 363(n). It seems that both Congress and bankruptcy commentators are satisfied with the current version of § 363(n) and its application by the courts.

This does not mean, however, that case law has applied the section consistently. To the contrary, there are splits in the case law on several different issues.

II. THE ELEMENTS AND APPLICATION OF § 363(N)

While the purpose of § 363(n) is relatively straightforward, several issues make the section's operation considerably more nuanced. A party bringing an action under the section must initially establish the jurisdiction of the bankruptcy court and the standing to assert an objection. Beyond these predicates, the application of § 363(n) depends on several considerations. First, § 363(n) interacts with § 363(m). The two sections must be understood in tandem. Second, the elements of an objection under § 363(n) must be considered. It is important to understand how evidence of an agreement may be demonstrated, and the subtle differences between collusion and collaboration. Third, the range of remedies available are critical to any party considering, or defending, an action under § 363(n). Fourth, in addition to these civil remedies, violators of § 363(n) may also face criminal penalties.

A. *Jurisdiction and Standing*

There is almost no case law discussing the jurisdictional basis for a § 363(n) action, likely because the jurisdictional basis for the section is not controversial. The Bankruptcy Court for the Eastern District of California made this clear in *In re Eads*.³⁵ In that decision, the court held that cases involving § 363(n) “arise under” Title 11 of the U.S. Code and that such actions therefore “are firmly anchored on federal jurisdiction.”³⁶ No other case has questioned this straightforward issue.

³⁴ NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS, NATIONAL BANKRUPTCY REVIEW COMMISSION FINAL REPORT, *in* COLLIER ON BANKRUPTCY, App. G, Pt. 44 (Lawrence P. King et al. eds., 15th ed. rev. 2006).

³⁵ *Hawkins v. Don Bricker Constr., Inc. (In re Eads)*, 135 B.R. 387 (Bankr. E.D. Cal. 1991).

³⁶ *Id.* at 392.

The issue of whether a party has standing to bring a § 363(n) action is not so straightforward. The Second Circuit Court of Appeals addressed this issue at length in *In re Colony Hill Associates* (“*Colony Hill*”).³⁷ This case involved a party (“Kabro”) attempting to make a bid on the debtor’s property the day before the sale hearing and several days after the bid submission deadline had passed.³⁸ The previous higher bidder (“Holiday”) argued, unsurprisingly, that the court should disqualify Kabro’s bid because Kabro had failed to comply with the bidding procedures.³⁹ Initially, the stalking horse bidder and the other creditors did not oppose Kabro’s bid.⁴⁰ However, once Holiday increased its bid to an amount very close to Kabro’s bid and with more favorable conditions, the principal secured creditor in the case changed its mind and informed the court that it opposed Kabro’s bid.⁴¹ The court approved the sale to Holiday and Kabro appealed, arguing that the sale resulted from collusion between Holiday and other creditors.⁴² The court of appeals heard the case after the district court dismissed Kabro’s appeal.⁴³

While the substance of Kabro’s allegations involved collusion, the court of appeals only briefly mentioned § 363(n) in its decision. The case primarily addressed the issue of whether Holiday was a good faith purchaser under § 363(m).⁴⁴ The case applies to issues raised by a § 363(n) claim, however, because its discussion of standing directly addresses whether an unsuccessful bidder has standing to appeal a sale order when there are allegations of collusion.⁴⁵ The court began its standing analysis by noting that appellate standing for a sale order derives “from former section 39(c) of the Bankruptcy Act of 1898, which permitted only a ‘person aggrieved’ to appeal an order of the bankruptcy court.”⁴⁶ An “aggrieved person” is “one who is directly and

³⁷ *Kabro Assocs. of W. Islip, LLC v. Colony Hill Assocs.* (*In re Colony Hill Assocs.*), 111 F.3d 269 (2d Cir. 1997).

³⁸ *Id.* at 271–72 (Holiday’s bid for real estate owned by the debtor was \$8.1 million. Kabro’s tardy bid was for \$10 million).

³⁹ *Id.* at 272.

⁴⁰ *Id.* (“The two secured creditors and [the stalking horse bidder] . . . initially stated either that they were amenable, upon certain conditions, to Kabro’s participation in the auction, or that they favored a brief adjournment to further evaluate Kabro’s bid.”).

⁴¹ *Id.* (“[A]fter Holiday increased its bid to \$9.6 million and agreed to close on the purchase notwithstanding an appeal by Kabro, [the secured creditor] opposed Kabro’s participation in the bidding.”).

⁴² *Id.*

⁴³ *Id.* at 273.

⁴⁴ See discussion *infra* Part II.B.1.

⁴⁵ *Colony Hill*, 111 F.3d at 273 (quoting *Kane v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 843 F.2d 636, 641–42 (2d Cir. 1988)).

⁴⁶ *Id.*

adversely affected pecuniarily by the challenged ruling of the bankruptcy court.”⁴⁷ The court noted that “Holiday correctly point[ed] out that under this standard, an unsuccessful bidder—whose only pecuniary loss is the speculative profit it might have made had it succeeded in purchasing property at an auction—usually lacks standing to challenge a bankruptcy court’s approval of a sale transaction.”⁴⁸

This general rule, however, is not absolute. The court cited several other cases providing that a party has standing to challenge the *fairness* of a bankruptcy proceeding.⁴⁹ Applying this logic to the case, the court held that Kabro had standing for three reasons. First, Kabro was not an “unknown party” to the debtor and creditor that had swooped in to challenge the sale after it had closed.⁵⁰ Second, Kabro was challenging the “intrinsic fairness” of the sale hearing. This is in contrast to a party filing an appeal “merely complaining that the bankruptcy court abused its discretion by excluding its bid.”⁵¹ Third, the court pointed out that “when collusion occurs between a debtor, creditors and a successful bidder, the unsuccessful bidder may be the only party with an interest in exposing such inequitable conduct.”⁵² Therefore, according to the *Colony Hill* holding, an unsuccessful bidder should frame its appeal as a challenge to the fairness of the auction, rather than simply an action seeking damages for losing the opportunity to purchase the debtor’s assets.

Other courts addressing this issue have focused on fairness as well.⁵³ For example, in *In re Hat*,⁵⁴ the Bankruptcy Court for the Eastern District of California found that the unsuccessful bidder had standing to appeal a sale order “not because it lost a bidding contest with another party, but because it allege[d] that two potential bidders colluded with a third party who held a statutory right of first refusal [under § 363(i)] thus tainting the sale.”⁵⁵

⁴⁷ *Id.* (internal quotation marks deleted) (quoting *Kane*, 843 F.2d at 641).

⁴⁸ *Id.* (citing 2 COLLIER ON BANKRUPTCY ¶ 5.06 (Lawrence P. King ed., 15th ed. rev. 1996)).

⁴⁹ *See id.* at 273–74.

⁵⁰ *Id.* at 274.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *See Dick’s Clothing & Sporting Goods, Inc. v. Phar-Mor, Inc.*, 212 B.R. 283, 289–90 (N.D. Ohio 1997) (“[The unsuccessful bidder] has standing to challenge the sale order, but only insofar as [the unsuccessful bidder] alleges that the sale was not made in good faith.”).

⁵⁴ *Wine Group v. Diamante (In re Hat)*, 310 B.R. 752 (Bankr. E.D. Cal. 2004).

⁵⁵ *Id.* at 758. This case involved an ex-wife of the debtor who had a statutory right of first refusal under § 363(i) on the sale of a winery that was community property between the debtor and the ex-wife. The unsuccessful bidder alleged that a potential bidder (“PBI”) entered into an agreement with the ex-wife that PBI would pull out of the auction and, once the ex-wife exercised her right of first refusal, PBI would pay the ex-

Likewise, the Bankruptcy Court for the District of Vermont held in *In re American Paper Mills of Vermont* (“*Paper Mills*”)⁵⁶ that an official committee of unsecured creditors had standing to challenge a sale of a debtor’s assets on the grounds that two of the bidders entered into a collusive agreement.⁵⁷ The court followed the accepted test in the Second Circuit providing that a Committee must establish the following criteria to bring an action that is normally reserved for the trustee: “(i) the Committee must have the consent of the debtor in possession or trustee, and (ii) the Court finds that suit by the [C]ommittee is (a) in the best interests of the bankruptcy estate, and (b) is ‘necessary and beneficial’ to the fair and efficient resolution of the bankruptcy proceedings.”⁵⁸

The *Paper Mills* court ultimately found that the Committee had standing to appeal the sale order.⁵⁹ First, the court recognized that the trustee consented to the Committee’s prosecution of the action.⁶⁰ Second, the court held that the action was “in the best interest of the bankruptcy estate because, if successful, it would result in a money judgment in favor of the chapter 11 estate, against an apparently solvent party.”⁶¹ Third, the court held that the action was “necessary and beneficial to the fair resolution of the allegations [of collusion] raised at the time of the sale.”⁶²

Note, however, that while the *Paper Mills* court followed this three-step process for determining whether the Committee had standing, any committee seeking to bring a § 363(n) action could also look to 11 U.S.C. § 1109(b) which provides that “[a] party in interest, including the debtor, the trustee, a creditors’ committee, an equity security holders’ committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.”⁶³ As long as the party in

wife a three percent commission and the ex-wife would then transfer her rights in the property to PBI. The ex-wife won the auction and an unsuccessful bidder challenged the sale as collusive. The court ultimately ruled that a new sale should be conducted and restricted the ex-wife’s exercise of her § 363(i) rights by requiring her to make full disclosure of all investors, co-owners and sources of financing and provided that any bidder in the new sale would be allowed to raise their bid to match the ex-wife’s bid, with each party being allowed to raise the bid until someone dropped out. *See generally id.*

⁵⁶ *In re Am. Paper Mills of Vt., Inc.*, 322 B.R. 84 (Bankr. D. Vt. 2004).

⁵⁷ *Id.* at 92.

⁵⁸ *Id.* (citing *Glinka v. Murad (In re Housecraft Indus. USA, Inc.)*, 310 F.3d 64, 70 (2d Cir. 2002)).

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ 11 U.S.C. § 1109(b) (2000).

interest alleges that collusion among bidders caused the property to sell at an artificially low price, the clear text of § 1109(b) should allow that party to bring a § 363(n) action.

Although case law and § 1109(b) seem to provide a firm basis for allowing a party in interest to bring a § 363(n) action, the holding in *In re Mark Bell Furniture Warehouse*⁶⁴ illustrates that this is not always the case. In that case, the First Circuit Court of Appeals considered whether a chapter 7 debtor had standing to appeal a sale order. In addition to addressing the issue of standing, this case is also notable because it involves the use of “relative” or “sharp” bidding practices.

The case involved a furniture store that was involuntarily placed into chapter 7 bankruptcy by its creditors.⁶⁵ One of the debtor’s assets was a pre-petition cause of action against another company (“Reid”).⁶⁶ When the trustee failed to pursue the claim against Reid, the president and sole shareholder of the debtor (“Bell”) offered to purchase the cause of action for \$250. A private auction of the cause of action was planned after Reid submitted a bid for \$501. The auction involved sealed bids. Bell submitted a sealed bid for \$1,000 and Reid’s sealed bid was “\$1,000 plus the amount of Bell’s bid.”⁶⁷ While the trustee and the bankruptcy judge both expressed concern regarding Reid’s “relative bid,” no objections were filed and the court approved the sale to Reid for \$2,000.⁶⁸

The debtor appealed the order, arguing that Reid’s relative bid should be declared void and that the trustee should be directed to accept Bell’s bid. The district court held that the appeal was moot because the debtor failed to obtain a stay of the sale order pending appeal under § 363(m).⁶⁹ In the court of appeals, the debtor argued that because of the relative bidding, the sale did not meet the “good faith” requirement under § 363(m).⁷⁰ The court did not rule on this issue because the issue was not properly preserved in the bankruptcy court.⁷¹ The court did, however, note that the “district court recognized the

⁶⁴ *Mark Bell Furniture Warehouse, Inc. v. D.M. Reid Assocs., Ltd. (In re Mark Bell Furniture Warehouse, Inc.)*, 992 F.2d 7 (1st Cir. 1993).

⁶⁵ *Id.* at 8.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.* (internal quotation marks omitted).

⁶⁹ *Id.*

⁷⁰ *Id.* at 9.

⁷¹ *Id.*

'problematic' nature of the 'bad faith' claim urged by Debtor, but decided that the presumed 'evil' of relative bidding lay in concealing the fact that a relative bid had prevailed."⁷² The court noted that the district court recognized that all active participants and all bystanders were informed of Reid's relative bid and were offered the chance to object.⁷³ Because no party objected, the court refused to find that Reid acted in bad faith.⁷⁴ The court also noted that its decision should not be seen as condoning relative bidding, but that the court would "leave for another day whether relative bidding is ever appropriate or practicable in the context of a judicial sale."⁷⁵

As to the issue of standing, the court held that the well-established rule is that a chapter 7 debtor is not considered a "person aggrieved" for appeal purposes because the debtor lacks a pecuniary interest in the property of the estate. The two exceptions to this rule are: "(1) if the debtor can show that a successful appeal would generate assets in excess of liabilities, entitling the debtor to a distribution of surplus under Bankruptcy Code § 726(a)(6) . . . or (2) the order appealed from affects the terms of the debtor's discharge in bankruptcy."⁷⁶ Because neither of these exceptions were met, the court held that the Chapter 7 debtor lacked standing to bring the action. Whether or not the relative bidding affected the "intrinsic fairness" of the sale was not a factor considered by the court.

B. The Application of § 363(n)

Whenever section 363(n) is invoked, a number of statutory issues are implicated. In almost all cases, the application of § 363(n) will occur alongside § 363(m). Understanding the relationship between the two sub-sections is important to any analysis of § 363(n). In addition to the interaction between the two sub-sections, the precise contours of a § 363(n) action are discussed below. The specific elements raise familiar questions that turn on issues of fact from case to case. These issues will involve the sufficiency of evidence necessary to demonstrate collusion, the circumstances surrounding any alleged collusion, and the degree to which discussions between parties are simple collaboration, or more meaningful collusion.

⁷² *Id.*; see also discussion *infra* Part II.B.2.a.2.

⁷³ *In re* Mark Bell Furniture Warehouse, Inc., 992 F.2d at 9.

⁷⁴ *Id.*

⁷⁵ *Id.* at 9 n.3.

⁷⁶ *Id.* at 10 (quoting *Kowal v. Malkemus (In re Thompson)*, 965 F.2d 1136, 1144 (1st Cir. 1992)).

1. *The Relationship Between § 363(n) and § 363(m)*

This Article is focused on the issue of collusive bidding and its prohibition under § 363(n). However, as is already apparent from the case law discussed above, § 363(n) is often discussed alongside § 363(m). Like § 363(n), the text of § 363(m) is fairly brief and straightforward. Section 363(m) reads:

The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.⁷⁷

The Second Circuit Court of Appeals has addressed both the general purpose of § 363(m) and how § 363(m) intersects with § 363(n). In *In re Gucci*,⁷⁸ the court analyzed whether a purchaser acted in good faith as required by § 363(m).⁷⁹ The case dealt with an appeal of a sale order by licensees of the Paulo Gucci trade name. Paulo Gucci was the chief designer for the family's business in Italy. He left the company in 1983 and formed his own line of designer products. After litigation on how Paulo Gucci would be allowed to market his products, he was prohibited from using "Paulo Gucci" as a trademark, but was allowed to identify himself as the designer of the products he sold. The products were marketed under the name "Paulo" with a notation that they were designed by Paulo Gucci. In 1994, Paulo Gucci filed for Chapter 11 bankruptcy and died shortly thereafter. The bankruptcy estate's primary asset was the Paulo Gucci name and an auction was set for the sale of all rights in the name. Bidders included Guccio Gucci (the original company that Paulo left in 1983) and various licensees of the Paulo Gucci name. Guccio Gucci won the auction and the licensees appealed, arguing that Guccio Gucci and the trustee colluded and that Guccio Gucci did not purchase the name in good faith because Guccio Gucci explicitly stated that it was purchasing the name to terminate the licenses and shut down the Paulo Gucci line of products. In other words, the licensees argued that Guccio Gucci acted "with the intent to destroy [the licensees] in violation of public policy."⁸⁰

⁷⁷ 11 U.S.C. § 363(m) (2000).

⁷⁸ *Licensing by Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.3d 380 (2d Cir. 1997).

⁷⁹ For the facts of this case, see generally *id.* at 384–85.

⁸⁰ *Id.* at 391.

The court held that Guccio Gucci's intentions did not constitute bad faith and did not violate public policy.⁸¹ In analyzing whether Guccio Gucci acted in bad faith, the court considered the purpose of § 363(m), noting that the § 363(m) good faith requirement is designed to maximize the purchase price of the assets that were sold.⁸² “[W]ithout this assurance of finality, purchasers could demand a large discount for investing in a property that is laden with the risk of endless litigation as to who has rights to estate property.”⁸³

As was noted by the court, the issue of collusion is an integral part of this “good faith” requirement under § 363(m).⁸⁴ If a court finds a party engaged in collusion, the party's good faith is lost.⁸⁵ The *In re Gucci* court tied this issue of good faith under § 363(m) to the provisions of § 363(n) by noting that § 363(m) acts as a shield to protect good faith purchasers from having a consummated sale reversed, while § 363(n) acts as a sword that “empowers the Trustee to avoid a sale if the sale price resulted from an understanding between potential bidders at the sale.”⁸⁶ In other words, § 363(n) “provides a more direct statutory prohibition on the conduct of the purchaser.”⁸⁷

2. *The Elements of a § 363(n) Cause of Action*

The Bankruptcy Court for the District of Arizona distilled the elements of a § 363(n) action down to a simple three-part test.⁸⁸ In *In re Sanner*, a gravel pit owned by the debtor was auctioned off and sold to Fort McDowell Sand & Gravel for \$275,000.⁸⁹ Madison Granite Company had bid \$586,000 in a prior sale that did not close for unspecified financial reasons. Following the sale, the trustee sued Fort McDowell and Madison Granite after discovering a written agreement providing that Fort McDowell would bid \$275,000, Madison Granite would not bid, and if Fort McDowell were to win then the companies would form a jointly-owned company to own and operate the gravel pit.

⁸¹ *Id.* at 393.

⁸² *Id.* at 387.

⁸³ *Id.* (citing case law).

⁸⁴ *Id.* at 388.

⁸⁵ *Id.* at 390 (“A purchaser's good faith is lost by ‘fraud, collusion between the purchasers and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders.’”). The *Gucci* court cites the two cases most often cited for the issue of what constitutes “good faith” under § 363(m): *In re Abbotts Dairies of Pennsylvania, Inc.*, 788 F.2d 143, 147 (3d Cir. 1986), and *In re Rock Industries Machinery Corp.*, 572 F.2d 1195, 1198 (7th Cir. 1978).

⁸⁶ *In re Gucci*, 126 F.3d at 391.

⁸⁷ *Id.*

⁸⁸ *Birdsell v. Fort McDowell Sand and Gravel (In re Sanner)*, 218 B.R. 941 (Bankr. D. Ariz. 1998).

⁸⁹ For the facts of this case, see generally *id.* at 943.

Although they acknowledged that the agreement was drafted, Fort McDowell and Madison Granite disputed that it was in effect at the time of the sale. The court refused to grant summary judgment to the trustee, holding that the effectiveness of the agreement, and whether it controlled the sale price,⁹⁰ was a genuine issue of material fact.

While the *In re Sanner* court did not find it necessary to substantively address each element of a § 363(n) claim, it took the opportunity to state these elements in a succinct manner. “Section 363(n) . . . requires that several things occur before the Trustee can either void the sale or seek damages: (1) there must be an agreement; (2) between potential bidders; (3) that controlled the price at bidding.”⁹¹ Courts have addressed each of these elements.

a. Evidence of an Agreement to Collude

An agreement to collude is a necessary element of § 363(n). These agreements may be inferred by the behavior of parties or through other circumstances. Even when an agreement would not otherwise be collusive, its disclosure to the court weighs heavily in the determination under § 363(n). This line between simple cooperation and improper collusion continues to be forged in the courts.

i. Circumstantial Evidence of an Agreement to Collude

Courts have considered specific, written agreements when analyzing whether parties colluded.⁹² Some of these cases involve parties that specifically disclosed the contents of the agreement to the court.⁹³ It is clear, however, that an explicit written agreement among potential bidders is not necessary for a court to find that there was an agreement to collude. The agreement to collude may be oral or inferred from the circumstances.⁹⁴ How a

⁹⁰ See discussion *infra* Part II.B.2.c.

⁹¹ *In re Sanner*, 218 B.R. at 944. While some courts refer to collusion “*between*” potential bidders, the text of § 363(n) refers to collusion “*among*” potential bidders. Compare *id.* with 11 U.S.C. § 363(n) (2000).

⁹² See, e.g., *In re Hat*, 310 B.R. 752, 756–57 (Bankr. E.D. Cal. 2004) (discussing that the agreement into which the parties entered that the court ultimately found collusive was written in a memorandum of understanding and signed by both parties); *In re Sanner*, 218 B.R. at 944 (noting that the parties did not dispute the existence of a written agreement that appeared to control the sale price, but rather disputed that it was actually in effect at the time of the sale); *In re Stroud Ford, Inc.*, 163 B.R. 730, 733–34 (Bankr. M.D. Pa. 1993).

⁹³ See discussion *infra* Part II.B.2.a.

⁹⁴ See *Lone Star Indus., Inc. v. Compania Naviera Perez Companac, Sudacia (In re N.Y. Trap Rock Corp.)*, 42 F.3d 747, 753 (2d Cir. 1994) (“To the extent [the plaintiff’s] complaint alleges that it was a term of

court should weigh such circumstantial evidence was the focus of the District Court for the Northern District of Indiana in *Boyer v. Gildea*.⁹⁵

Boyer involved an appeal of a going-concern sale of a debtor's assets.⁹⁶ Prior to the auction, Arlington Capital, a potential purchaser, negotiated with Comerica, the debtor's largest secured creditor, to determine an acceptable sale price. Comerica and Arlington Capital arrived at a price of \$2.7 million five days before the auction.⁹⁷ At the same time that Arlington Capital was negotiating with Comerica, Comerica was working with a separate group to finance an offer. The group ("Gildea group") was a joint venture consisting of an employee and an accountant of the debtor, together with Chris Gildea, the son of the president and sole equity owner of the debtor. The proposed acquisition was for \$3.7 million, but the financing did not close, allegedly because the Gildea group did not trust Comerica due to its past dealings with the company.⁹⁸

Also prior to the auction, Arlington Capital discussed the possibility of entering into a joint venture with the Gildea group to bid for the debtor's assets. Arlington Capital and the Gildea group drafted a joint venture agreement to form a new entity ("GT Holdings"), but the agreement was never executed, and it was not clear whether the entity was ever actually formed.⁹⁹ Arlington Capital did, however, forward a draft bid to Comerica approximately ten days prior to the auction. The agreement listed GT Holdings as the bidder but did not disclose the membership of GT Holdings. Negotiations between Arlington Capital and the Gildea group continued up until the date of the auction.¹⁰⁰ A week before the auction, Arlington Capital formed a new entity (GTA Acquisition) for the purpose of acquiring the debtor's assets. At the auction, the only parties submitting bids for the debtor's assets were Comerica and GTA Acquisition. GTA Acquisition won the auction, and the court approved the sale. At no time prior to the auction was Comerica, the trustee, or the court aware of the negotiations between Arlington Capital and the Gildea group.

the [allegedly collusive] agreement (whether written or unwritten) that [a potential bidder] would drop out of the bidding . . . the complaint alleges a prohibited voidable transaction under § 363(n).")

⁹⁵ *Boyer v. Gildea*, No. 1:05-CV-129-TLS, 2006 WL 2868924 (N.D. Ind. Oct. 5, 2006), *vacated in part*, 374 B.R. 645 (N.D. Ind. 2007).

⁹⁶ *Id.* at *10.

⁹⁷ *Id.*

⁹⁸ *Id.* at *10.

⁹⁹ *Id.*

¹⁰⁰ *Id.* at *12.

Shortly after the sale closed, a company called GT Enterprises purchased GTA Acquisition.¹⁰¹ GT Enterprises was jointly owned by an employee and an accountant of the debtor who were also part of the Gildea group, and by Katherine Gildea, the wife of Chris Gildea. The sale from Arlington Capital to GT Enterprises was pursuant to an agreement dated either on the same date as the auction (according to the trustee) or three days later (according to the defendants).¹⁰²

Exactly one year after the sale closed, the trustee brought an adversary proceeding against, among others, the Gildea group, Katherine Gildea, Arlington Capital, GT Acquisition and GT Enterprises. Among the trustee's claims was the claim that the defendants violated § 363(n) by entering into an agreement to control the sale price of the debtor's assets. The trustee theorized "that by not disclosing their negotiations with Arlington, Comerica believed that Arlington's bid through GT Acquisition was the most they could receive for the Debtor's assets, and that there was no collusion in connection with the § 363 sale."¹⁰³ In other words, but for Arlington's dealings with GT Enterprises, other parties—including GT Enterprises, the Gildea group, or some other combination of these parties—would have participated in the bidding and the debtor's assets would have sold for a higher price.

In determining whether § 363(n) was violated, the court considered whether an agreement existed.¹⁰⁴ The court initially noted that the actual agreement between Arlington and GT Enterprises could not form the basis of a § 363(n) violation because the bid deadline was April 2, 2003 and the agreement was not entered into until, at the earliest, April 7, 2003. Furthermore, the agreement made "no reference to the auction or to the price of the assets purchased at the auction."¹⁰⁵ The trustee alleged, however, that even if no explicit agreement existed, the circumstances indicated a conspiracy to collude. Citing antitrust law, the trustee argued that the inference of an agreement could be made when the parties had an incentive to collude. The court responded to this argument by writing:

¹⁰¹ The court noted that it was unclear when GT Enterprises was formed. *Id.* at *11.

¹⁰² The agreement was actually dated the same day as the auction (April 7, 2003), but the defendants in the case alleged that this was a typographical error and the correct date was April 10, 2003. *Id.* at *12. The agreement "allowed [GT Enterprises] to purchase GTA Acquisition by paying Arlington \$517,000 plus Arlington's cash contribution to GTA Acquisition. Arlington would also receive 10% of GT Acquisition's 2003 profits. [GT Enterprises] also paid an extra \$100,000 commission to Arlington." *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.* at *14 (citing *Birdsell* for its three-part test to determine liability under § 363(n)).

¹⁰⁵ *Id.*

Though the anti-trust framework is not perfectly analogous to that of a § 363(n) claim, the approach to analyzing the sufficiency of the evidence to show the existence of an agreement to restrain trade is helpful in analyzing the sufficiency of the evidence showing the existence of an agreement to control the price at a bankruptcy sale. . . . To show a contract or conspiracy to restrain trade or commerce in violation of § 1 of the Sherman act [sic], a plaintiff relying on circumstantial evidence must show the inference of conspiracy is reasonable in light of the competing inference of independent action. Because there is often only a fine line separating unlawful concerted action from legitimate business practices, '[c]onduct [that is] as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of an antitrust conspiracy.'¹⁰⁶

The court concluded that the circumstances in this case did not provide sufficient evidence to show a collusive agreement. It noted that the evidence upon which the trustee relied could have just as easily been compatible with permissible conduct and that, therefore, the court would not infer that a collusive agreement existed.¹⁰⁷

Consequently, if an inference of permissible conduct can reasonably be drawn from evidence that may also tend to indicate that collusion occurred, a court should not infer that a collusive agreement existed. Other courts have similarly adopted this position.¹⁰⁸

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* ("Plaintiff cannot point to any evidence tending to exclude the possibility that the Defendants [sic] conduct was permissible."). However, the district court revisited the factual basis for this conclusion nearly a year later. In response to the trustee's motion for reconsideration, the district court changed direction, concluding that "the Court's erroneous assumption that the Gildea Group independently declined financing from Comerica justifies reconsidering and vacating its order granting summary judgment on Count V. . . . [The trustee] focus[e]d on evidence that the Court overlooked." *Boyer v. Gildea*, 374 B.R. 645, 662 (N.D. Ind. 2007).

¹⁰⁸ See *In re Colony Hill Assocs.*, 111 F.3d 269, 276–77 (2d Cir. 1997) (refusing to overturn the bankruptcy court's finding that the winning bidder purchased the assets in good faith, because "[t]he bankruptcy court could properly believe" the winning bidder's account of the circumstances surrounding the bidding); *In re N.Y. Trap Rock Corp.*, 42 F.3d 747, 753 (2d Cir. 1994) (noting that a party that dropped out of the bidding could have done so "for other, innocent reasons" as opposed to the collusive allegations made by a losing bidder); *In re Sasson Jeans, Inc.*, 90 B.R. 608, 611–12 (S.D.N.Y. 1988) (holding that "[t]he fact that a successful bidder is a creditor of the estate does not, standing alone, raise an inference that the sale is a product of fraud or collusion," and noting that the bankruptcy court considered the "totality of the circumstances" and rejected the inference that the winning bidder obtained the debtor's assets through fraud or collusion); *In re Miami Gen. Hosp., Inc.*, 81 B.R. 682, 689 (S.D. Fla. 1988) (acknowledging that a bank holding the first lien on the hospital debtor attempted to get other parties to bid higher so that the property could be sold at a high price without the bank having to purchase and operate the hospital while looking for another buyer, and holding that

ii. *Disclosure of the Agreement*

Section 363(n) case law includes several examples of situations where a party accused of entering into a collusive agreement argues that the agreement could not have been improper because it was fully disclosed to both the bankruptcy court and the other parties. Several courts have found that disclosure weighs heavily in the accused party's favor. But, parties contemplating entering into a bidding agreement should be aware that disclosing the agreement to the court does not act as a "get out of jail free" card.¹⁰⁹

The issue of disclosure arises, in many cases, where parties have challenged a purchaser's good faith status.¹¹⁰ In addition to the issue of standing discussed *supra*, the Second Circuit Court of Appeals addressed disclosure in *Colony Hill*.¹¹¹ After concluding plausible reasons existed for the successful bidder, the debtor, and other creditors to object to the unsuccessful bidder's bid, the court noted that "despite allegations . . . of secret, conspiratorial dealings between [the parties], all relevant facts regarding the parties' bids and positions were disclosed to the bankruptcy court."¹¹² The court, contrasting this case to cases where the dealings were concealed from the court, ultimately concluded that "[a]lthough full disclosure to the bankruptcy court may not always neutralize conduct that would otherwise

the bank's motivations could not be considered collusion because the efforts were an attempt to *increase* the ultimate sale price). The court therefore vacated the prior decision granting summary judgment and held that the issue of collusion was for a jury to decide. As to the use of the antitrust law framework to require a 363(n) plaintiff to show that collusion was "more reasonable than an inference of independent action," the court held that the reasonableness of such a framework was moot because the facts, as reconsidered by the court, indicated that the inference of collusion was more reasonable than the inference of independent action. *See id.* at 662. The court noted, however, that "the same logic that motivated the higher standard for antitrust cases applies to the situation here." *Id.* Therefore, the framework discussed in the vacated opinion remains helpful in guiding potential bidders. Moreover, other courts have adopted the "reasonable inference" framework for use in determining whether collusion occurred.

¹⁰⁹ For an extensive discussion of the issue of disclosure in bankruptcy cases, see Flaccus, *supra* note 16, at 301.

¹¹⁰ *Colony Hill*, 111 F.3d at 277 (contrasting the facts in this case with allegations of concealment that amounted to fraud on the court as in the case of *Tri-Cran, Inc. v. Fallon (In re Tri-Cran)*, 98 B.R. 609 (Bankr. D. Mass. 1989)).

¹¹¹ *See supra* notes 37–43 and accompanying text (discussing the facts of *Colony Hill*).

¹¹² *Colony Hill*, 111 F.3d at 277.

constitute bad faith, disclosure should certainly weigh heavily in a bankruptcy court's decision on that issue."¹¹³

Other courts have emphasized the importance of disclosure.¹¹⁴ The Tenth Circuit addressed the issue in *In re Broadmoor Place Investments*.¹¹⁵ This decision involved the sale of a debtor's assets in a single asset realty bankruptcy case.¹¹⁶ The chapter 11 debtor signed an agreement with G-K Development Company, Inc. ("G-K") to sell the realty for \$5.7 million, subject to G-K obtaining financing and other contingencies.¹¹⁷ The bankruptcy court did not approve the agreement, and later held that the agreement was not a contract, but rather only a bid to purchase the property. The debtor later entered into another "agreement" to sell the building—this time to Robinson. Robinson bid \$5.5 million cash, with no material contingencies, and a \$50,000 earnest money deposit. When questioned about the propriety of entering into two agreements, the debtor responded that it considered Robinson's bid a "back-up" in case it could not close the sale with G-K.¹¹⁸ At the sale hearing, the debtor offered G-K's bid as its first choice, but the court approved the sale of the assets to Robinson, holding that Robinson's bid was the best offer because it had fewer contingencies and allowed for a more immediate closing.¹¹⁹ G-K appealed, alleging, among other things, that the debtor

¹¹³ *Id.* at 277–78 (upholding the bankruptcy court's decision that collusion did not occur in this case, but also "caution[ing] that bankruptcy judges should remain alert to the possibility of fraud or collusion with respect to the sale of a debtor's property").

¹¹⁴ *See, e.g.,* *Dick's Clothing & Sporting Goods, Inc. v. Phar-Mor, Inc.*, 212 B.R. 283, 294 (N.D. Ohio 1997) ("[T]he parties here disclosed all relevant facts to the Bankruptcy Court. [The successful bidder] disclosed the nature of the [allegedly-collusive] Agreements and urged the Bankruptcy Court to make any sale of the property subject to the Agreements.").

¹¹⁵ *G-K Development Co. v. Broadmoor Place Invs., L.P. (In re Broadmoor Place Invs., L.P.)*, 994 F.2d 744 (10th Cir. 1993).

¹¹⁶ For the facts of this case, see generally *id.* at 745.

¹¹⁷ *Id.*

¹¹⁸ *Id. In re Broadmoor Place Invs., L.P.*, 994 F.2d at 745.

¹¹⁹ *Id.* In addition to its allegations of collusion, G-K argued that the bankruptcy court was improperly participating in the administration of the debtor's estate by "selecting" a particular bid. *See id.* at 745–46 (arguing that the court was "performing administrative duties which, since the Bankruptcy Code of 1978, have been the sole responsibility of the trustee or debtor in possession, not the Court."). The court of appeals held that:

[W]hile there is support for [G-K's] position that a Bankruptcy Court cannot be presented with competing bids from which *it* is to choose, since that would involve it in an impermissible participation in the administration of a bankrupt's estate, we hold that a Bankruptcy Court in a case such as this does have the power to disapprove a proposed sale recommended by the trustee or debtor-in-possession if it has an awareness there is another proposal in hand which, from the estate's point of view, is better or more acceptable.

colluded with Robinson because it concealed a management contract into which the debtor and Robinson entered.¹²⁰ The court upheld the lower court's finding of no collusion, stating that "as to the said management contract, while its details were not specified, the fact of its existence between Robinson and [the debtor] was specifically set forth in the Robinson bid on which the Bankruptcy Court acted, thus negating any claim of concealment and collusion."¹²¹

Potential bidders should be mindful, however, that despite full disclosure, some courts have found agreements impermissibly collusive. For example, in *In re Stroud Ford, Inc.*,¹²² the Bankruptcy Court for the Middle District of Pennsylvania considered the propriety of an agreement among potential bidders that was specifically disclosed to the court. The case dealt with a debtor seeking to sell its Ford dealership to an individual named Raymond Price.¹²³ The debtor's motion to sell the dealership to Price was opposed by, among others, John Katsaros and Harold Bendell ("Katsaros/Bendell").¹²⁴ Katsaros/Bendell were prospective bidders and claim traders. Katsaros/Bendell's objection argued that the debtor's proposed sale was not to the highest and best bidder. Attached to the objection was a bid from Katsaros/Bendell. At the sale hearing, counsel for the debtor announced that Price and Katsaros/Bendell had entered into an "understanding" whereby Price would pay Katsaros/Bendell \$18,000 to withdraw their objection to Price's bid. The court raised the issue of § 363(n) *sua sponte* and noted that "[t]he agreement by Katsaros/Bendell to withdraw their objection for the sum of [\$18,000] may very well have been seen by the parties to be a legitimate business transaction ending what might have proven to be an expensive controversy."¹²⁵ However, the court held that "[a]s innocent and business-like as this 'understanding' was to the parties involved, this Court finds that it smacks of inappropriateness and could only have stifled the bankruptcy mechanism designed to ensure that the estate is fairly compensated for its assets."¹²⁶ The court therefore held that Price had not acted in good faith.¹²⁷

Id. at 746.

¹²⁰ *Id.*

¹²¹ *Id.* at 746 (The court considered the presentation of G-K's bid as the debtor's first choice to be further circumstantial evidence against the allegations of collusion.)

¹²² *In re Stroud Ford, Inc.*, 163 B.R. 730 (Bankr. M.D. Pa. 1993).

¹²³ For the facts of this case, see generally *id.* at 731–33.

¹²⁴ *Id.* at 731.

¹²⁵ *Id.* at 733.

¹²⁶ *Id.*

¹²⁷ *Id.* at 734.

The *In re Stroud Ford* court is not alone in cautioning that disclosure of an agreement will not relieve parties of what otherwise is a violation of § 363(n). In considering the propriety of a sale, the Bankruptcy Court for the Eastern District of Pennsylvania stated that it believed:

that the proponents of the Sale Motion overstate[d] the prophylactic consequences of disclosure on a determination of collusion. Under their analysis, it would appear that an agreement intending to control price that actually does control price could be blessed by a court so long as all its terms were revealed.¹²⁸

The court held that it was more sensible to use disclosure not as a cure-all but as a factor that weighs heavily in a bankruptcy court's decision on the issue of collusion.¹²⁹

Any potential bidder in a bankruptcy sale should fully disclose any agreement with other potential bidders. However, all parties should consider the other elements of a § 363(n) violation because disclosure alone likely will not be sufficient to get the sale approved if the agreement violates § 363(n).

iii. Collusion Versus Collaboration

Despite the importance of the issue, few courts have addressed where to draw the line between impermissible collusion and the normal business practice of making a collaborative joint bid with another party.¹³⁰ This issue was touched upon by the court in *In re Edwards*.¹³¹

In re Edwards involved the chapter 7 bankruptcy case of Joe Edwards.¹³² Edwards owned one third of the stock in Pilot Corporation ("Pilot").¹³³ This stock and the debtor's interest in a partnership (collectively, the "Assets") were the only significant assets in the case. The chapter 7 trustee soon realized that the only interested buyers of the Assets would be other Pilot stockholders. The trustee initially filed a motion to sell the Assets to the CEO of Pilot ("Phillips")

¹²⁸ *In re Edwards*, 228 B.R. 552, 565 (Bankr. E.D. Pa. 1998).

¹²⁹ *Id.* (citing *In re Colony Hill Assocs.*, 111 F.3d 269 (2d Cir. 1997)).

¹³⁰ This issue also concerned the Commission on the Bankruptcy Laws of the United States during discussions on the enactment of § 363(n). See *supra* note 28 and accompanying text.

¹³¹ *In re Edwards*, 228 B.R. at 552.

¹³² For the facts of this case, see generally *id.* at 554–60.

¹³³ *Id.* at 555.

for \$3.4 million.¹³⁴ Phillips submitted his bid in his individual capacity, but was also supported by Pilot and an individual named Drescher (Phillips, Pilot, and Drescher were referred to as the “Pilot Group”). Included in Phillips’s bid was an agreement by Pilot and Drescher to waive millions of dollars of claims they had against the debtor’s estate. The terms of the sale also included an agreement by the trustee to waive any claims the estate had against Pilot and Phillips.

At a hearing on the trustee’s motion, the court heard evidence that the Assets were worth \$2.745 million.¹³⁵ This valuation was premised on the sale of a minority interest in Pilot. However, an individual named Wesley Wyatt believed that he held a sufficient interest in Pilot to be able to assert a majority interest by purchasing the Assets. Wyatt argued that he owned 45% of the Pilot stock through the exercise of certain stock options. The extent of Wyatt’s holdings in Pilot stock was the subject of ongoing litigation in New Jersey state court between Wyatt, Edwards and Phillips. Wyatt initially attempted to get the bankruptcy court to decide the disputed ownership issue. The court refused, holding that it did not have jurisdiction, but also recognizing that the uncertainty of whether a controlling interest was at stake was benefiting the estate.¹³⁶

After the court’s ruling on the ownership issue, Wyatt tendered a bid for \$3.6 million for the Assets. Wyatt’s bid did not, and could not, resolve any of the claim issues between Phillips, Drescher, Pilot and the estate. The trustee sought to accept the Phillips offer, even though it was lower than Wyatt’s offer, because of the releases included in the Phillips offer. Wyatt later increased his bid to \$5 million in cash, supplemented by a \$3 million bond to secure payment of Pilot Group claims when litigated. After Wyatt submitted his increased bid, a “new” bidder emerged. Phillips had collaborated with various employees and franchisees of Pilot in order to make a bid of \$5.1 million, complete with a full settlement of the mutual claims among the parties. At this time, the three bids submitted were from the Pilot Group, Wyatt, and Phillips and the employees/franchisees.

¹³⁴ *Id.* at 554–55. The initial motion was filed by the trustee on March 12, 1998. This motion merely “initiat[ed] the saga” of the sale of these assets. The final hearing did not occur until October 30, 1998. *Id.* at 555.

¹³⁵ *Id.*

¹³⁶ *Id.* at 556.

At the next, and final, hearing, yet another grouping of individuals emerged to bid on the Assets. Wyatt and Phillips had joined together to bid \$5.2 million, with complete mutual releases. The record reflected evidence of a global settlement agreement between Wyatt, Phillips, and Pilot. The settlement agreement settled all disputes between the parties and provided how the company would be owned and operated once the sale closed.

The trustee accepted this bid. The debtor objected, arguing that bid was the result of collusion between Phillips and Wyatt. In response to the debtor's allegations of collusion, the court analyzed whether the sale was made in good faith.¹³⁷ The court acknowledged that Wyatt and Phillips's joint bid was a result of collaboration among the parties,¹³⁸ but held that the issue turned on the motivations of the parties and whether they were seeking to control the sale price.¹³⁹ The court concluded that the motivation of the collaborating parties was not to control the price, but rather to obtain a favorable settlement agreement.¹⁴⁰

The issue of "controlling" the sale price will be discussed in depth *infra*, but standing on its own, the *In re Edwards* decision sheds some light on the murky issue of collusion versus collaboration. The holding provides some measure of assurance to potential bidders. If potential bidders collaborate on a bid, they will probably not run afoul of § 363(n) if they can demonstrate that they were motivated to collaborate for innocent reasons. These reasons can include the formation of a favorable settlement agreement, as discussed in *In re Edwards*, or the inability of each collaborating party to afford an individual bid.¹⁴¹

b. Among Potential Bidders

The second element of a § 363(n) action is that an agreement must be "among potential bidders."¹⁴² This element of a § 363(n) claim is generally not an issue. As illustrated by the cases already discussed, courts have broadly

¹³⁷ *Id.* at 563 (citing *In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143 (3d Cir. 1986)).

¹³⁸ *Id.* at 563 n.23 (analyzing § 363(n) case law to understand "the line between unlawful collusion and permissible collaboration").

¹³⁹ *Id.* at 563–65 (analyzing in detail the facts and holding of *In re N.Y. Trap Rock Corp.*, 42 F.3d 747 (2d Cir. 1994)).

¹⁴⁰ *Id.* at 566.

¹⁴¹ *See, e.g.*, *Boyer v. Gildea*, No. 1:05-CV-129-TLS, 2006 WL 2868924, at *15 (N.D. Ind. Oct. 5, 2006) ("A joint bid is not necessarily an attempt to restrict bidding. Parties might make a joint bid where they could not afford to make a bid individually.").

¹⁴² 11 U.S.C. § 363(n) (2000).

interpreted the term “potential bidders,” holding that the term can include parties that submit a bid, parties that express interest but do not submit a bid,¹⁴³ the Committee of Unsecured Creditors,¹⁴⁴ or the debtor itself.¹⁴⁵ That said, the Bankruptcy Court for the District of Massachusetts held that § 363(n) did not specifically apply in the case because the only alleged collusion occurred between the debtor and the purchaser of the assets.¹⁴⁶ The court wrote:

The Trustee also claims to state a cause of action under 11 U.S.C. section 363(n), which permits a court to vacate a sale for collusion “among bidders.” However, the complaint alleges collusion between the sole bidder and the Debtor in Possession, not among bidders, so section 363(n) does not apply to this case.¹⁴⁷

While it is true that a debtor generally will not bid on the sale of estate assets, this holding seems overly technical and ignores the fact that a debtor, while not a bidder, can be a party to a collusive agreement.¹⁴⁸

Finally, because a § 363(n) claim must involve an agreement among potential *bidders*, courts have addressed whether the section applies in all § 363 sale scenarios. The Eighth Circuit addressed this question by holding that § 363(n) applies to both public and private § 363 sales.¹⁴⁹ In addition, the Bankruptcy Court for the Middle District of Pennsylvania has held that § 363(n) applies to all § 363 sales, whether or not they are structured as auctions.¹⁵⁰

¹⁴³ See, e.g., *id.* at *14–17 (addressing the alleged collusion of the “Gildea group” even though the group did not submit a bid).

¹⁴⁴ See, e.g., *In re Am. Paper Mills of Vt., Inc.*, 322 B.R. 84, 92 (Bankr. D. Vt. 2004) (holding that the Committee of Unsecured Creditors had standing as a “potential bidder” to bring a § 363(n) action).

¹⁴⁵ *G-K Development Co. v. Broadmoor Place Invs., L.P. (In re Broadmoor Place Invs., L.P.)*, 994 F.2d 744 (10th Cir. 1993).

¹⁴⁶ *Tri-Cran, Inc. v. Fallon (In re Tri-Cran, Inc.)*, 98 B.R. 609 (Bankr. D. Mass. 1989).

¹⁴⁷ *Id.* at 618.

¹⁴⁸ See, e.g., *In re Broadmoor Place Invs., L.P.*, 994 F.2d at 744 (considering whether the debtor colluded with another potential bidder).

¹⁴⁹ See *Ramsay v. Vogel*, 970 F.2d 471, 474 (8th Cir. 1992) (citing the legislative history of § 363(n) and holding that § 363(n) should be applied in private sales because “[t]he collusion among prospective purchasers that the trustee’s complaint alleges is precisely the evil Congress intended to deal with in § 363(n).”).

¹⁵⁰ See *In re Stroud Ford, Inc.*, 163 B.R. 730, 733 (Bankr. M.D. Pa. 1993) (“Even though this [sale] hearing was not scheduled as an ‘auction,’ this Court has not difficulty in identifying [the parties] as ‘potential bidders.’”).

c. *Controlling the Sale Price*

The final element to a claim under § 363(n) requires that the agreement entered into by potential bidders must “control” the sale price of the assets. The leading case on this issue was decided by the Second Court of Appeals in *In re New York Trap Rock Corp.* (“*New York Trap Rock*”).¹⁵¹ This case involved Chapter 11 debtor Lone Star Industries, Inc. (“Lone Star”). In an effort to liquidate its interest in the South American cement market, Lone Star sought to sell its wholly-owned Argentine subsidiary, Compania Argentina de Cemento Portland, S.A. (“CACP”).¹⁵² CACP, in turn, owned a 50% interest in Cemento San Martin (“CSM”), an Argentine cement producer. The other 50% was owned by Patagonica. Patagonica was the wholly-owned subsidiary of Perez.¹⁵³

CSM’s by-laws provided that each joint venturer (CACP and Patagonica) had a right of first refusal in the event that the other joint venturer sold its 50% interest to a third party.¹⁵⁴ Lone Star marketed its interest,¹⁵⁵ and the only party to submit an initial bid was Perez for \$36 million. After more marketing, a company called Loma Negra submitted a bid for \$38 million.¹⁵⁶ While Loma Negra’s bid was on the table, and without disclosure to Lone Star or to the bankruptcy court, Loma Negra signed an agreement to purchase Patagonica’s 50% interest in CSM for \$55 million. The bankruptcy court later approved the sale of Lone Star’s interest in CSM to Loma Negra.¹⁵⁷

Several months after the sale, Lone Star filed an adversary proceeding alleging that Loma Negra violated § 363(n) when it failed to reveal its dealings with Patagonica.¹⁵⁸ The bankruptcy court denied summary judgment to Lone Star and granted summary judgment to the defendant on the ground that § 363(n) does not apply when the agreement affects, rather than controls, the sale price.¹⁵⁹ The district court affirmed the bankruptcy court decision.¹⁶⁰

¹⁵¹ *In re N.Y. Trap Rock Corp.*, 42 F.3d 747 (2d Cir. 1994).

¹⁵² For the facts of this case, see generally *id.* at 749–51.

¹⁵³ In the decision, the court provided a helpful diagram to illustrate the relationship between Lone Star, CACP, Perez, Patagonia and CSM. *Id.* at 750.

¹⁵⁴ *Id.*

¹⁵⁵ The asset being sold was CACP, but because of the relationship between CACP and CSM, for the purposes of the case, the court considered ownership of CACP to be “the substantial equivalent of ownership of the half interest in CSM.” *Id.* at 749.

¹⁵⁶ *Id.* at 750.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.* at 750–51.

¹⁵⁹ *Id.* at 751.

On appeal, the Second Circuit first summarized Lone Star's position that Loma Negra violated § 363(n) because its agreement with Patagonica *affected* the sales price of Lone Star's interest.¹⁶¹ The court cited the text of § 363(n) which prohibits agreements that "control" the sale price.¹⁶² The court then noted that the common definition of "control" "implies more than acts causing an incidental or unintended impact on the price; it implies an intention or objective to influence the price."¹⁶³ The court went on, providing:

It is most unlikely Congress would have intended to prohibit all agreements that *affect* a sale price. Such a prohibition would cover a vast range of innocent agreements among potential bidders; it would furthermore be very difficult for the parties to an agreement to recognize that their agreement was unlawful. They would need to make an imaginative exploration of the potential consequences of their agreement to determine whether it had a potential to affect the price of the auction sale.¹⁶⁴

The court therefore rejected Lone Star's argument and held that to be liable under § 363(n), "[t]he influence on the sale price must be an intended objective of the agreement, and not merely an unintended consequence. . . ."¹⁶⁵ The court therefore affirmed the district court's denial of summary judgment in Lone Star's favor because Lone Star argued that an agreement *affecting* the sale price was a violation of § 363(n).¹⁶⁶

¹⁶⁰ *Id.*

¹⁶¹ Specifically, the Debtor's argued that "[b]y purchasing Perez's . . . interest in CSM, Loma Negra effectively eliminated Perez's incentive to bid for Lone Star's half of CSM, with the result that Loma Negra encountered no bidding opposition; [the Debtor's] interest was then sold for less than would have been realized had Loma Negra and Perez been competitors. . . ." *Id.* at 751–52.

¹⁶² *Id.* at 752.

¹⁶³ *Id.* (citing the legislative history of § 363(n)).

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* (emphasis added).

¹⁶⁶ *Id.* (emphasis added). The court reversed the grant of summary judgment in favor of the defendants. *Id.* at 753. The court noted that in addition to alleging that Loma Negra's agreement affected the sale price, Lone Star also alleged that:

Loma Negra paid \$55 million not only to acquire Perez's half interest in CSM, but also to induce Perez to drop out of the bidding for Lone Star's share so that, notwithstanding its higher value, it could be sold to Loma Negra at a low price, with Perez and Loma Negra sharing the difference.

Id. The court stated that if these allegations were true, it would "come[] close to the classic collusive bidding against which [§ 363(n)] is directed." *Id.* Therefore, the court remanded this issue, noting that Loma Negra would be entitled to summary judgment if Lone Star could not show, after discovery, that there was a genuine issue for trial "as to whether Perez and Loma Negra had an agreement that Perez would drop out after selling its half to Loma Negra." *Id.* at 754.

New York Trap Rock sets a high bar that a § 363(n) plaintiff must clear to demonstrate liability. The specific, intended objective of an agreement must be to cause the property to sell for a lower price than it might have sold for, had the agreement not been entered into.

The few other courts analyzing this specific issue have unanimously adopted the “affect versus control” framework.¹⁶⁷ In addition the Bankruptcy Court for the Eastern District of Pennsylvania took this analysis another step by noting that even if the court finds that the parties entered into an agreement to control the price, such a finding “is not sufficient by itself to require disapproval of the sale. Absent a showing that the agreement *actually did* deprive the estate of fair value for the assets, the sale should be confirmed.”¹⁶⁸

3. Remedies Under Section 363(n)

Section 363(n) provides two distinct remedies for collusive bidding, although their structure undermines their application. The *Paper Mills* court addressed the dual remedies under § 363(n), noting that:

[T]he statute would have been clearer if Congress had bifurcated § 363(n) into two distinct provisions: one provision that allowed damages from potential bidders who engaged in efforts to control the bidding; and another provision that allowed the trustee to set aside a sale based on the impact of such an agreement. However, Congress did not do that; rather, it conglomerated into a single subsection both remedies that are available against parties involved in schemes to control bidding.¹⁶⁹

Despite the fact that § 363(n) is somewhat unclear on this point, determining what types of remedies are available under the section is not particularly difficult. A trustee, or any other party bringing the action,¹⁷⁰ may seek to set aside the sale *or* may seek consequential damages in the amount of the difference between what the property sold for and for what it should have

¹⁶⁷ See *Boyer v. Gildea*, No. 1:05-CV-129-TLS, 2006 WL 2868924, at *17 (N.D. Ind. Oct. 5, 2006) (summarizing the holding of *New York Trap Rock* and holding that “[i]n this case, even if the Plaintiff could show that the Defendants entered into an agreement, he could not show that the agreement controlled the price at auction”); *In re Hat*, 310 B.R. 752, 759 (Bankr. E.D. Cal. 2004) (“There is no disputing that [the defendants] colluded. The evidence also shows that their collusion controlled the price at which the Capello Winery sold.”); *In re Edwards*, 228 B.R. 552, 566 (Bankr. E.D. Pa. 1998).

¹⁶⁸ *In re Edwards*, 228 B.R. at 566 (emphasis added).

¹⁶⁹ *In re Am. Paper Mills of Vt., Inc.*, 322 B.R. 84, 89 (Bankr. D. Vt. 2004).

¹⁷⁰ See *supra* Part II.

sold. Trustees have sought these remedies in the alternative.¹⁷¹ In addition, whichever remedy the trustee selects, he may also elect to recover costs, attorney's fees, expenses, and punitive damages.¹⁷²

Courts have discussed the election between setting aside the sale and seeking damages in the context of whether applicable statutes of limitations bar a § 363(n) sale. This issue is discussed in the next section. Otherwise, aside from mentioning the types of damages available, courts have not addressed the damage provisions of § 363(n), likely because the section lays out the damages available in a relatively straightforward manner.¹⁷³

4. *Criminal Penalties*

The text of § 363(n) does not, however, specifically mention criminal liability for collusion. Aside from a passing reference, case law discussing § 363(n) has not addressed criminal liability for violating the section.¹⁷⁴ Moreover, little commentary has discussed the issue.¹⁷⁵ Such a dearth of case law and commentary should not lull potential bidders into complacency. Title 18 of the U.S. Code lists at least two statutes under which a colluding party could be prosecuted criminally. Section 152 of title 18 provides that, in a bankruptcy case, a party can be held criminally liable for knowingly and fraudulently making a false oath or filing a false statement under penalty of perjury.¹⁷⁶ Liability could therefore arise, for example, if a party falsely denies that any collusion occurred when questioned by the court at the sale hearing. Moreover, § 152 provides that parties can be held liable for knowingly and

¹⁷¹ See, e.g., *Gumport v. China Int'l Trust and Inv. Corp. (In re Intermagnetics Am., Inc.)*, 926 F.2d 912, 915 (9th Cir. 1991).

¹⁷² *In re Eads*, 135 B.R. 387, 392 (Bankr. E.D. Cal. 1991).

¹⁷³ The Bankruptcy Code also provides that property recovered under § 363(n) is considered property of the estate. 11 U.S.C. § 541(a)(3) (2000). Case law has not addressed whether "property" includes all monetary damages recovered by a party other than the trustee. However, while such a party may be able to recover attorneys fees, costs, and expenses, § 363(n) specifically provides that any punitive damages are recovered "in favor of the estate." Because a § 363(n) action is an action on behalf of all creditors seeking to remedy an unfair sale, see *supra* Part II.A, the consequential damages will almost certainly be considered property of the estate as well.

¹⁷⁴ *In re Edwards*, 228 B.R. 552, 560 (Bankr. E.D. Pa. 1998) (noting that the debtor's argument that a late bid "represented . . . impermissible (and perhaps criminal) collusion.").

¹⁷⁵ See *Flaccus*, *supra* note 16, at 331–40 (stating that a party may be subject to criminal liability for failing to disclose relevant information in a case involving collusion); *Bowles*, *supra* note 16, at 831 (noting that "bidders should . . . take great care" because of the possibility of criminal liability for collusion). For a general discussion of criminal liability under the Bankruptcy Code, see Bruce A. Markell, *Bankruptcy, Lenity, and the Statutory Interpretation of Cognate and Criminal Statutes*, 60 IND. L.J. 335 (1994).

¹⁷⁶ 18 U.S.C. § 152(2)-(3) (2000).

fraudulently receiving property “with intent to defeat the provisions of title 11.”¹⁷⁷ Another section of title 18 that could be applied to collusive activities is the prohibition of “bankruptcy fraud.”¹⁷⁸ Section 157 generally prohibits false or fraudulent schemes and representations in connection with a bankruptcy case. These provisions should stand as a clear warning to potential bidders that the consequences of violating § 363(n) may be more serious than simple monetary damages.

III. THE FINALITY OF SALE ORDERS

Despite that a party may successfully carry the burden on a § 363(n) claim, procedural issues may remain. First and foremost, the defending party may assert a statute of limitations defense under Federal Rule of Civil Procedure 60(b). Concern over the statute of limitations has also driven interest in similar claims to fill in for the possibly time-barred § 363(n) claim. Some courts have been receptive to less specific fraud on the court claims. Understanding the details of both of these possibilities, and their possible interactions, is the final step in the collusion analysis.

A. *The Statute of Limitations on a § 363(n) Claim—Does § 363(n) Trump Rule 60(b)?*

Imagine your business purchased assets in a bankruptcy sale three years ago. After reviewing the elements of § 363(n) and the damages available under the section (especially the provisions providing for punitive damages and criminal liability), you are concerned that the deal you struck with another bidder was collusive. First, shame on you for colluding. Second, you might escape liability because many courts have held that parties have a limited time to bring a § 363(n) action.

Because the text of § 363(n) does not mention any statute of limitations, it has fallen to the courts to analyze how (or whether) a time limitation on § 363(n) actions applies. The provisions of Federal Rule of Civil Procedure 60(b) can be read to time-bar § 363(n) actions. Rule 60 is titled “Relief From Judgment or Order” and subsection (b) is titled “Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, Etc.” The text of the rule provides that final orders can be set aside for several different reasons

¹⁷⁷ *Id.* § 152(5).

¹⁷⁸ *Id.* § 157.

including newly discovered evidence, as well as “fraud (whether heretofore denominated intrinsic or extrinsic), misrepresentation, or other misconduct of an adverse party. . . .”¹⁷⁹ If a final order qualifies under these two reasons, the rule further provides that a motion to set aside the order must be made within one year after the order was entered.

Because § 363(n) actions are based on allegations of impermissible collusion, some courts have interpreted actions under the section as motions to set aside the sale order under the fraud/misconduct element of Rule 60(b). Specifically, the Bankruptcy Court for the Middle District of Pennsylvania considered this issue in *In re Taylorcraft Aviation Corp.* (“*Taylorcraft*”).¹⁸⁰ Almost two years after a § 363 sale had closed, the chapter 7 trustee brought a § 363(n) action seeking damages for alleged collusion between the purchaser and certain other parties. The defendants moved to dismiss the action, arguing that Rule 60(b) applied to § 363(n) actions and that the one-year limitations period had run. The court agreed inasmuch as the one-year limitations period under Rule 60(b) applies to motions to set aside a sale under § 363(n). The court disagreed, however, with the blanket assertion that there is a one-year statute of limitations on § 363(n) actions.¹⁸¹ The court noted that when a statute (such as § 363(n)) does not specifically provide for a statute of limitations, “a federal court will ordinarily ‘borrow’ the most closely analogous state statute of limitations of the state where the district court is held.”¹⁸² The court therefore applied the two-year limitation period under the Pennsylvania statute of limitations for fraudulent, or otherwise tortious conduct.¹⁸³

In applying the state statute of limitations, the court made it clear that actions to set aside a sale under § 363(n) (as opposed to actions for damages under § 363(n)) *would* be subject to the one-year limitation period under Rule 60(b).¹⁸⁴ However, because the trustee in this case was seeking *damages*, the two-year statute of limitations “borrowed” from Pennsylvania law was more

¹⁷⁹ FED. R. CIV. P. 60(b)(3) (2007).

¹⁸⁰ *Szybist v. Aircraft Acquisition Corp.* (*In re Taylorcraft Aviation Corp.*), 163 B.R. 734 (Bankr. M.D. Pa. 1993).

¹⁸¹ *Id.* at 737 (“[The defendant] argues that the limitation period has run under [Rule] 60(b) and more particularly, that Rule 60(b)(3) is applicable to claims brought pursuant to § 363(n). This Court agrees. This Court, however, does not agree that the one (1) year statute of limitation period provided for in Rule 60 is the actual statute of limitations that this Court should look to in making the instant determination.”).

¹⁸² *Id.* at 738 (quoting 2 JAMES WM. MOORE ET AL., MOORE’S FEDERAL PRACTICE ¶ 3.08[2] at 3–43).

¹⁸³ *Id.*

¹⁸⁴ *Id.*

appropriate.¹⁸⁵ Therefore, according to the *Taylorcraft* holding, a party may bring a § 363(n) action more than one year after the sale order was entered, provided only damages are sought and the applicable state limitations period has not run.¹⁸⁶ The Bankruptcy Court for the District of Vermont in *Paper Mills* adopted this holding as well.¹⁸⁷

The Bankruptcy Court for the Southern District of New York, however, appears to disagree with the *Taylorcraft* holding. In *In re Clinton Street Food Corp.* (“*Clinton Street*”),¹⁸⁸ the court considered whether a § 363(n) action could be brought more than three years after a § 363 sale.¹⁸⁹ There, the chapter 7 trustee agreed to sell the assets to Rudy Fuertes for \$300,000, subject to higher and better offers.¹⁹⁰ Unbeknownst to the chapter 7 trustee, a representative of a competitor of the debtor, Maui Pineapple Co., (“Maui”) had agreed to pay defendants Fuertes, Laufer and Zorn (together with Maui, the “Defendants”) \$50,000, \$50,000 and \$70,000, respectively, not to bid.¹⁹¹ The Defendants did not disclose the scheme to the trustee and “also failed to disclose it to the bankruptcy court even though [the bankruptcy judge] expressly asked the [D]efendants and their counsel at the sale hearing ‘whether they were aware of the existence of any agreement to control the sale price.’”¹⁹²

No other bids were submitted at the auction and Maui’s bid of \$320,000 was accepted.¹⁹³ It was later determined that the assets were worth at least \$2 million.¹⁹⁴ Almost five years after the sale order was entered, the trustee brought an adversary proceeding against the Defendants, alleging fraud, fraud

¹⁸⁵ *Id.* (“While this Court acknowledges that a Trustee’s attempt to void an Order under Section 363(n) is subject to the time limitations imposed in Rule 60 . . . the Trustee, in this case, is not seeking to avoid an Order approving the sale. . .”).

¹⁸⁶ The limitations period under state statutes of limitations for fraud generally range from two to six years. See Vincent R. Johnson & Shawn M. Lovorn, *Misrepresentation by Lawyers About Credentials or Experience*, 57 OKLA. L. REV. 529, 534–35 (2004); Katherine F. Nelson, *The 1990 Federal “Fallback” Statute of Limitations: Limitations by Default*, 72 NEB. L. REV. 454, 511 (1993).

¹⁸⁷ *In re Am. Paper Mills of Vt.*, 322 B.R. 84, 90–91 (Bankr. D. Vt. 2004) (citing the *Taylorcraft* decision as “absolutely sound” and holding that the Vermont statute of limitations for a fraud action governed the limitations period for the § 363(n) action before the court).

¹⁸⁸ *Gazes v. Delprete (In re Clinton St. Food Corp.)*, 254 B.R. 523 (Bankr. S.D.N.Y. 2000).

¹⁸⁹ *Id.* at 530.

¹⁹⁰ *Id.* at 527.

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ *Id.*

on the court, violation of § 363(n), and fraudulent concealment.¹⁹⁵ The trustee later sought to amend his complaint to add certain additional factual allegations.¹⁹⁶ The court allowed the amendment, but dismissed the § 363(n) claim as time-barred pursuant to the Rule 60(b)(3) one-year statute of limitations.¹⁹⁷ The trustee moved for reconsideration and a different bankruptcy judge took up the issue.¹⁹⁸ The court noted that sale orders are final orders for res judicata purposes.¹⁹⁹ As to § 363(n), the court further noted that the judge in the prior decision had ruled that § 363(n) was governed by the limitations period of Rule 60(b)(3), and held that the prior ruling was the “law of the case”²⁰⁰ and would not be revisited.²⁰¹ The Defendants also asked the court to extend this holding to the common law claims (fraud and fraudulent concealment) brought by the trustee.²⁰² The court found that the common law claims were indistinguishable from claims under § 363(n), and therefore concluded that “they are not distinct for res judicata purposes; all of the claims depend on the bid rigging scheme and the issuance of the Sale Order, and seek damages based on the improper procurement of the Sale Order.”²⁰³ Furthermore, the court cautioned against allowing a § 363(n) claimant to avoid the one year period of limitations by structuring a § 363(n) claim as a claim for common law fraud.²⁰⁴ Finally, the court noted that ignorance of the collusive agreement is not sufficient to overcome the Rule 60 limitations period.²⁰⁵ The court therefore dismissed the common law claims and upheld the dismissal of the § 363(n) claim.²⁰⁶

¹⁹⁵ *Id.* at 528.

¹⁹⁶ *Id.* at 529.

¹⁹⁷ *Id.* at 529–30.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 530–31 (citing *In re Colony Hill Assocs.*, 111 F.3d 269, 272 (2d Cir. 1997), and *Gekas v. Pipin (In re Met-L-Wood Corp.)*, 861 F.2d 1012, 1017 (7th Cir. 1988)).

²⁰⁰ “Law of the case is a judicially created doctrine, the purpose of which is to prevent relitigation of issues that have been decided. . . . Under law of the case . . . a court will generally refuse to reopen or reconsider what has already been decided in an earlier stage of the litigation.” *Suel v. Sec’y. of Health & Human Servs.*, 192 F.3d 981, 984–85 (Fed. Cir. 1999); *see also Rezzonico v. H&R Block, Inc.*, 182 F.3d 144, 148–49 (2d Cir. 1999).

²⁰¹ *In re Clinton St.*, 254 B.R. at 531.

²⁰² *Id.*

²⁰³ *Id.* at 531.

²⁰⁴ *Id.* (“If a party could transform a § 363(n) damage claim into a common law claim and avoid the one year period of limitations, § 363(n) would become meaningless.”).

²⁰⁵ *Id.* at 532 (citing 12 JAMES WM. MOORE ET AL., MOORE’S FEDERAL PRACTICE § 60.65[2][a], at 60–200 (3d ed. 1999)).

²⁰⁶ *Id.* at 536.

The court's decision in *Clinton Street* seems inconsistent with the *Taylorcraft* holding. However, *Clinton Street* can be distinguished. First, the *Clinton Street* court did not actually rule on the issue of § 363(n). It simply noted the previous decision and held that the holding was the "law of the case."²⁰⁷ Any citation to this case for the overarching proposition that the Rule 60(b)(3) limitations period applies to § 363(n) can be countered by pointing out that the published opinion did not actually rule on the subject.²⁰⁸ Furthermore, the trustee in *Clinton Street* sought to set aside the sale order, while the plaintiffs in *Taylorcraft* and *Paper Mills* sought damages. As discussed above, this distinction was significant in *Taylorcraft*. Both the *Clinton Street* and the *Paper Mills* courts noted this distinction as well.²⁰⁹ Therefore, a litigant bringing a § 363(n) action more than one year after the sale order should frame the action as one for damages, as opposed to a motion to set aside the order.²¹⁰

Structuring the action as one for damages, however, is not the only basis that parties have used to bring what otherwise would be deemed a tardy § 363(n) action. Several cases have considered the § 363(n) limitations issue in the context of "fraud on the court" claims.

B. *Fraud on the Court Claims*

In addition to addressing the issues discussed above, the *Clinton Street* court also considered the trustee's claim of "fraud on the court." The court provided that the elements for a fraud on the court claim are:

- (1) the defendant's misrepresentation to the court,
- (2) the denial of the motion to confirm based on the misrepresentation,
- (3) the lack of

²⁰⁷ *Id.* at 531.

²⁰⁸ This was one of the reasons cited by the *Paper Mills* court in its holding. See *In re Am. Paper Mills of Vt., Inc.*, 322 B.R. 84, 90–91 n.3 (Bankr. D. Vt. 2004) (noting that the *Clinton Street* court did not rule on the issue and providing further that if any conflict does exist between *Clinton Street* and *Taylorcraft*, "the Court finds the *Taylorcraft* rationale regarding the determination of the applicable statute of limitations to be more legally sound.").

²⁰⁹ See *In re Clinton St.* 254 B.R. at 529 n.3 ("[B]ecause the Trustee is seeking to avoid the Sale Order by reasons of the defendants' alleged fraud, we characterize this § 363(n) claim as a motion under Rule 60(b)(3), and apply its one year statute of limitations.") (emphasis added); see also *In re Paper Mills*, 322 B.R. at 90 ("In reliance upon MOORE'S FEDERAL PRACTICE, the *Taylorcraft* court found that where the movant seeks not to set aside the sale, but instead to impose sanctions based upon collusive bidding behavior, that the statute of limitations is the state law statute of limitations for filing a fraud action. . . .").

²¹⁰ This will put the litigant on more firm footing regarding the statute of limitations issue, although the defendant would still be able to cite *Clinton Street* to argue that the plaintiff is using § 363(n) to bring what otherwise should be a common law fraud action.

an opportunity to discover the misrepresentation and either bring it to the court's attention or bring a timely turnover proceeding against the garnishee, and (4) the benefit the defendant derived from inducing the erroneous decision.²¹¹

The court held that the plaintiffs established the elements of fraud on the court, in part because the defendants "covered up" their scheme and lied to the court at the sale hearing.²¹² The court therefore refused to dismiss the trustee's claim of fraud on the court.²¹³

Other courts have considered the issue of whether a fraud on the court claim will allow a party to set aside a sale under § 363(n) when such a claim may otherwise have been time barred. The Bankruptcy Court for the District of Massachusetts discussed this issue in depth in *In re Tri-Cran, Inc.*²¹⁴ In this case, the debtor sought to sell real estate to defendant John Fallon.²¹⁵ The court approved the sale over the objections of several parties.²¹⁶ The chapter 7 trustee investigated the circumstances surrounding the sale and determined that various parties colluded with the debtor.²¹⁷ The investigation further determined that Fallon learned of the sale from his close friend, Gargiulo, who was a stockholder of the debtor.²¹⁸ But at the sale hearing, counsel for the debtor argued that Fallon learned of the sale through general knowledge of the cranberry industry.²¹⁹ The court specifically asked if Fallon had contacts with other stockholders and principals, and counsel for the debtor said no.²²⁰ Fallon, another attorney for the debtor, and Gargiulo were all present at this hearing and said nothing. The court later determined that one of the attorneys for the debtor knew these statements to be false.²²¹

²¹¹ *In re Clinton St.*, 254 B.R. at 533 (citing *Leber-Krebs, Inc. v. Capitol Records*, 779 F.2d 895, 899–900 (2d Cir. 1985)).

²¹² *Id.*

²¹³ *Id.*

²¹⁴ *In re Tri-Cran, Inc.*, 98 B.R. 609 (Bankr. D. Mass. 1989).

²¹⁵ *Id.* at 612.

²¹⁶ *Id.* at 621.

²¹⁷ Specifically, stockholders of the debtor (Serpa and Florindo) alleged that other stockholders (Gargiulo and Murphy) had engineered a sale to Fallon at a low price with an agreement that Gargiulo and Murphy would secretly retain control. Fallon learned of the sale from his close friend Gargiulo. But, at the sale hearing counsel for the Debtor said that Fallon learned of the sale through general knowledge of the cranberry industry. *Id.* at 620–21.

²¹⁸ *Id.* at 619.

²¹⁹ *Id.*

²²⁰ *Id.* at 620.

²²¹ *Id.* at 621.

The trustee filed an appeal seeking to set aside the order.²²² In considering the trustee's appeal, the court first noted that the trustee filed the action more than a year after the order was entered.²²³ The court concluded, however, that the Rule 60(b) limitation "*does not apply* when the basis of the motion is fraud upon the court."²²⁴ It was important in the court's analysis, however, to specify the type of "fraud" that was required to demonstrate fraud on the court.²²⁵ The court provided that "[a]s it has been applied, fraud on the court refers to a subcategory of fraud, misrepresentation, or other misconduct in which the fraud, misrepresentation or other misconduct is committed by the court, its personnel or its officers."²²⁶ Applying this analysis, the court held that "the judgment in [Fallon's] favor can be vacated for fraud on the court if it can be shown . . . that Fallon colluded with these officers of the court to obtain approval of the sale at the lowest price, and, to that end, colluded with them in perpetrating a fraud on the court."²²⁷ The court ultimately held that Fallon did not act in good faith because he colluded to keep the price low.²²⁸ The court vacated the sale and ordered Fallon to pay attorneys' fees, costs, and expenses incurred by the trustee in litigating the matter.²²⁹

The Ninth Circuit also addressed fraud on the court in a pair of decisions. In *In re Intermagnetics America, Inc.* ("*Intermagnetics*"),²³⁰ the court considered an appeal of a § 363 sale of the debtor's assets to the only company that submitted a bid.²³¹ The debtor's CEO submitted a sworn affidavit to the court that the purchasing company provided the only substantial written offer. In fact, the purchasing company was secretly set up by the CEO and the CEO had been in negotiations with another company, CITIC, to resell the assets for much more than the original selling price. The trustee did not discover evidence of these dealings until three years after the sale order was entered. The trustee filed an adversary proceeding against CITIC alleging fraud and collusion under § 363(n) and seeking damages or, in the alternative, avoidance

²²² *Id.* at 613.

²²³ *Id.*

²²⁴ *Id.* at 614 (emphasis added).

²²⁵ *Id.* at 615 (stressing that "fraud on the court must somehow be distinguished from the fraud, misrepresentation, and other conduct of an adverse party that is the subject of Fed.R.Civ.P. 60(b)(3). Otherwise, the one year limitation on motions under Rule 60(b)(3) would be rendered meaningless.").

²²⁶ *Id.* at 615–16.

²²⁷ *Id.* at 617.

²²⁸ *Id.* at 624.

²²⁹ *Id.*

²³⁰ *In re Intermagnetics Am., Inc.*, 926 F.2d 912 (9th Cir. 1991).

²³¹ For the facts of this case, see generally *id.* at 913–15.

of the sale. CITIC filed a motion to dismiss, arguing, among other things, that the § 363(n) claim was time-barred pursuant to Rule 60(b). The district court granted CITIC's motion. On appeal, the Ninth Circuit reversed, holding that "Rule 60(b) does not limit the power of a court to entertain an independent action to set aside a judgment for fraud upon the court."²³²

The holding in *Intermagnetics* could be interpreted as a general rule that Rule 60(b) does not limit actions under § 363(n). However, the court of appeals addressed the issue again three years later in *In re International Nutronics, Inc.* ("*Nutronics*").²³³ In this case, the court restricted the holding in *Intermagnetics* to actions involving fraud on the court.²³⁴ *Nutronics* involved an appeal of a sale of industrial sterilization materials containing cobalt-60, an isotope of the element cobalt.²³⁵ Cobalt-60 is highly radioactive and the market for such dangerous materials is very limited. The trustee sought bids for the materials and only received separate bids from two of the debtor's competitors (Isomedix and RSI). RSI later amended its bid, offering to pay 102% of any competing bid.²³⁶ The trustee rejected both bids. At this point, Isomedix and RSI knew that they were the only bidders. They notified the trustee that they had formed a joint venture to purchase the material. After negotiations, the trustee accepted the joint bid, and the sale was approved by the court.

Twenty-two months after the sale, the trustee filed an adversary proceeding against Isomedix and RSI alleging that their joint bid violated § 363(n). It appeared unclear to the court why the trustee accepted the joint bid and then waited almost two years before deciding that it was a violation of § 363(n). At any rate, the defendants moved for summary judgment, arguing that the res judicata effect of the sale order precluded the trustee's action. The court recognized that sale orders are entitled to res judicata effect and that § 363(n) is a statutory exception to the finality of such orders.²³⁷ The court also

²³² *Id.* at 916. The court also addressed CITIC's res judicata claim, holding that:

[Section] 363(n) provides a statutory exception to the finality of bankruptcy sale orders for res judicata purposes. A contrary finding would render meaningless the ability of a bankruptcy trustee to "avoid a sale" under § 363(n). Such a result would also be inconsistent with the exception to the finality of otherwise final orders provided by Fed. R. Civ. P. 60(b). . . .

Id. at 917–18.

²³³ *Robertson v. Isomedix, Inc. (In re Int'l Nutronics, Inc.)*, 28 F.3d 965 (9th Cir. 1994).

²³⁴ *Id.* at 968–69.

²³⁵ For the facts of this case, see generally *id.* at 967.

²³⁶ See *supra* notes 65–76 and accompanying text (discussing relative bidding).

²³⁷ *In re Int'l Nutronics*, 28 F.3d at 968 (quoting *In re Intermagnetics Am., Inc.*, 926 F.2d at 917).

addressed the trustee's assertion that § 363(n) is an exception to the limitation period under Rule 60(b). The court held that, while § 363(n) is generally an exception to the finality of sale orders, it "is not . . . a *wholly independent* exception to the rules of finality."²³⁸ The court characterized the trustee's claim as a motion under Rule 60(b)(3) and held that because the trustee "did not file a § 363(n) claim until twenty-two months after the bankruptcy court issued the sale order . . . the claim is time-barred."²³⁹

While *Nutronics* does not specifically hold that fraud on the court claims are an exception to this rule, it distinguishes the facts of the case from the *Intermagnetics* holding partly on this basis.²⁴⁰ Therefore, although the case law is not entirely clear on this point, litigants in the Ninth Circuit most likely will continue to rely on *Intermagnetics* to support the argument that a § 363(n) action alleging fraud on the court can be brought more than one year after the sale.

The cases discussed provide a basis for an argument that a fraud on the court claim is an exception to the Rule 60(b) limitation period, but this rule cannot be described as "generally accepted." In *Landscape Properties v. Vogel*,²⁴¹ for example, the Eighth Circuit expressed serious doubt that framing an action as fraud on the court has any substantive effect. In *Ramsay*, a chapter 7 trustee filed a § 363(n) action against the debtor and certain bidders, alleging that the sale of the debtor's assets at a private auction was marred by collusion among the defendants. The defendants demanded a jury trial, and the case was certified to the district court. The district court dismissed the case, holding that § 363(n) applies only to public auction.²⁴² The Eighth Circuit reversed, holding that § 363(n) applies both to public and private auctions.²⁴³

On remand, the jury acquitted the defendants. The trustee²⁴⁴ appealed the verdict to the Eighth Circuit once again. The court considered this appeal in

²³⁸ *Id.* at 969 (emphasis added).

²³⁹ *Id.* at 970.

²⁴⁰ *Id.* at 969 n.3. Another distinction between *Intermagnetics* and *Nutronics* is that the trustee in *Intermagnetics* was attempting to set aside the order or recover damages. The trustee in *Nutronics* was only seeking to set aside the order. Neither court addressed this distinction, but it may provide another ground for distinguishing the two holdings.

²⁴¹ *Landscape Props., Inc. v. Vogel*, 46 F.3d 1416 (8th Cir. 1995).

²⁴² *Ramsay v. Vogel*, 970 F.2d 471, 472 (8th Cir. 1992).

²⁴³ *Id.* at 474.

²⁴⁴ The party bringing the appeal at this point was the debtor-in-possession because the chapter 7 bankruptcy had been converted to a case under chapter 11. To prevent confusion, the appellant in *Landscape Properties* will continue to be referred to as the "trustee."

Landscape Properties. On appeal, the trustee argued, among other things, that the district court erred in refusing to allow the trustee to amend his complaint to add a fraud on the court claim.²⁴⁵ The trustee's allegations were based on statements and alleged omissions made at the sale hearing. At the hearing, the bankruptcy court asked the trustee if he was aware of any collusion. Because the trustee did not discover the alleged collusion until after the sale closed, the trustee responded that he knew of no collusion and that the debtor's attorney should be able to confirm that. Although the debtor's attorney was present, the bankruptcy court did not question him about collusion.

On appeal to the Eighth Circuit, the trustee alleged that the debtor's attorney's silence at the hearing was a fraud on the court because the attorney allegedly knew of collusion between the debtor and certain bidders. The *Landscape Properties* court considered the common definition of fraud on the court²⁴⁶ and concluded that the trustees' "claim of fraud on the court does not even come close to meeting that standard."²⁴⁷ The court further noted:

Indeed, apart from its pejorative character, the claim of fraud on the court adds nothing analytically to the basic claim under § 363(n). For in virtually every case in which a trustee files suit under that provision to challenge the sale of a bankrupt estate's property, the trustee will have been unaware of the alleged agreement to control the price of property when he sought and obtained the bankruptcy court's approval of the sale. It is § 363(n), and not any alleged fraud on the court, which determines whether the sale was improper.²⁴⁸

While this case does not involve the issue of limitations, the court's insistence that fraud on the court "adds nothing" to a § 363(n) claim could prove troublesome to a tardy § 363(n) litigant alleging that a special exception exists for fraud on the court claims. Moreover, § 363(n) litigants should be

²⁴⁵ For an extensive discussion of the facts and the holding in *Landscape Properties*, see Flaccus, *supra* note 16, at 331–40.

²⁴⁶ *Landscape Props., Inc. v. Vogel*, 46 F.3d 1416, 1422 (8th Cir. 1995) ("Fraud on the court, though not easily defined, can be characterized as a scheme to interfere with the judicial machinery performing the task of impartial adjudication, as by preventing the opposing party from fairly presenting his case or defense. A finding of fraud on the court is justified only by the most egregious misconduct directed to the court itself, such as bribery of a judge or jury or fabrication of evidence by counsel, and must be supported by clear, unequivocal and convincing evidence." (quoting *Pfizer Inc. v. Int'l Rectifier Corp.* (*In re Coordinated Pretrial Proceedings in Antibiotic Antitrust Actions*), 538 F.2d 180, 195 (8th Cir. 1976))).

²⁴⁷ *Id.* (noting that the court did not question the attorney directly, that the attorney "neither made affirmative misrepresentations to the court nor fabricated evidence," and that every party that was questioned about collusion responded truthfully).

²⁴⁸ *Id.*

aware of a Seventh Circuit case that strictly applied the Rule 60(b) limitation period. In *In re Met-L-Wood Corp.*,²⁴⁹ the court did not discuss fraud on the court, but applied the Rule 60(b) limitation period even though there was convincing evidence of bid rigging.²⁵⁰ In affirming the dismissal of the case as time-barred, Judge Posner wrote:

This result may seem a harsh one; it may seem to illustrate the penchant of courts (as some would see it) to work injustice through technicalities. But insistence on tight deadlines is not always the sign of a Prussian soul. Unless bankruptcy sales are final when made, rather than subject to being ripped open years later, high prices will not be offered for the assets of bankrupt firms—and the principal losers (pun intended) will be unsecured creditors.²⁵¹

The *Landscape Properties* and *In re Met-L-Wood Corp.* cases do not directly address the issue of whether a § 363(n) claim alleging fraud on the court is barred by the Rule 60(b) time limitation. However, § 363(n) litigants should be aware that this dicta may be used to counter the general assertion that limitation periods should not be strictly applied and that § 363(n) claims alleging fraud on the court are not subject to the Rule 60(b) time limitation.

CONCLUSION

The case law discussed in this Article can be used as the basis for broad guidelines that will allow potential bidders the best chance for avoiding liability under § 363(n). Potential bidders entering into an agreement should first consider how that agreement will appear to the court and the other parties in the case. In addition, parties should always disclose the terms of the agreement to the court, although this disclosure alone is not sufficient to avoid liability.

Potential bidders should ensure that they have standing to bring a § 363(n) action by framing the action as a lawsuit seeking to rectify an unfair sale. Such an action can only be successful if the plaintiff can show that the defendants entered into an agreement to collude. Circumstantial evidence of such an agreement may be sufficient, but not if the evidence could just as easily prove that the defendants engaged in innocent dealings. The plaintiff must also show that the agreement controlled the sale price, rather than simply affecting it, and

²⁴⁹ Gekas v. Pipin (*In re Met-L-Wood Corp.*), 861 F.2d 1012 (7th Cir. 1988).

²⁵⁰ *Id.* at 1019.

²⁵¹ *Id.*

that, but for the agreement, the property would have sold for a higher price. Defendants found liable under § 363(n) face damages including setting aside the sale, or consequential monetary damages and costs, including attorneys' fees and the costs of bringing the action. Criminal liability is also possible. Finally, if a potential § 363(n) plaintiff is considering bringing an action more than one year after the sale has closed, the plaintiff should consider framing the defendant's behavior as a fraud on the court. Otherwise, the court may hold that the action is time-barred.

With a rise in the popularity of § 363 sales, the issue of collusion will likely be addressed by more courts. Until further specific guidance is provided, parties should take special care to "play nice" when participating in a bankruptcy sale. Erring on the side of caution should ensure that the sale is consummated and that the order approving the sale is not later overturned.

