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Highest Dollar Bid Not Always the Best

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When the gavel strikes and the bankruptcy auction concludes, generally the highest dollar bid is the winning bid, and the debtor or trustee seeks court approval of this bid.

However, under certain circumstances, a debtor or trustee may seek court approval of a bid with a lower monetary value if that bid has fewer contingencies or contains certain intangible value, such as continuing business operations in a small community, guarantying jobs and ongoing business for suppliers. Moreover, in certain industries, such as healthcare, courts take into account societal needs, such as a healthcare facility's mission and the public health needs of the community.

Under §363(b) of the Bankruptcy Code, a trustee or debtor in possession may sell property of the estate after notice and a hearing.[1] As a general rule, to obtain approval of a sale of the debtor's assets, the debtor must show that there is a "good business reason" for the sale.[2]

In determining whether a good business reason has been established, the bankruptcy court will consider certain key factors, including: (i) whether the purchase price is reasonable; and (ii) whether the asset is decreasing or increasing in value.

Because a trustee or debtor in possession has the duty to maximize the value obtained from an asset sale, when competing bids are readily comparable, the highest dollar bid will almost always be the winning one.[3] But when competing bids differ in terms of price, terms and contingencies, bankruptcy courts have much greater latitude in determining which bid is highest and best.

Accordingly, courts take into account the ability of a bidder to close the transaction quickly, whether regulatory approval may be problematic, the preservation of jobs and in the case of the sale of a healthcare facility, the public health interests, needs of the community and the healthcare facility's mission.

Healthcare: a High Bid Loses

In re United Healthcare System Inc.[4] involved the sale of the Children's Hospital of New Jersey. Because the debtor was experiencing serious financial difficulties and was about to close, it notified the Commissioner of Health and Senior Services of New Jersey of its predicament prior to its bankruptcy filing.

Given the importance of the services provided by the hospital to the community and the hospital's liquidity problems, the commissioner advanced United Healthcare $3 million and supported a sale of its assets in order to transfer its pediatrics care services. To preserve the children's hospital, the commissioner also issued a moratorium against the hiring of medical staff for a brief period of time.

On Feb. 5, 1997, United Healthcare circulated to potential bidders a request for proposals (RFP) to purchase United Healthcare's assets on an expedited basis. On Feb. 15, 1997, final bids were submitted by St. Barnabas Healthcare System (St. Barnabas) for $13 million cash, University of Medicine and Dentistry of New Jersey/Cathedral Healthcare Systems Inc. (UMDNJ) for $12 million plus the wavier of a $1.2 million unsecured claim, and a third bidder that subsequently withdrew its bid.

The next day, United Healthcare's board considered the proposals and chose St. Barnabas as the winning bidder. On Feb. 18, 1997, an agreement for the sale of United Healthcare's assets was executed, which required United Healthcare to file for bankruptcy so that the purchaser would not be responsible for any liabilities not assumed.

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The agreement also required both parties to apply to the commissioner for certificates of need (CON) and licenses. On the same day, the commissioner expedited the review process and granted United Healthcare's application for a CON authorizing the closing of its hospital and granting the application of St. Barnabas for a CON and license to operate a pediatric acute care facility.

The day after the applications were granted, United Healthcare filed its Chapter 11 case and moved for approval of the sale to St. Barnabas. After a four-day hearing, the bankruptcy court refused and declared the sale to be a "nullity" because the board's decision in choosing St. Barnabas as the winning bidder was not a sound business judgment in light of the fact that UMDNJ's offer saved more jobs, provided more protection for physician contracts and was for more money, given the waiver of UMDNJ's $1.2 million claim.[5] The court criticized the sale process undertaken by United Healthcare because it prevented the court from obtaining a fair price through a 363 sale, particularly when UMDNJ made a $5 million higher offer during the sale hearing.[6]

In reversing the bankruptcy court, the district court stated:

"Instead of measuring the 'good faith' judgment of the Board, the Bankruptcy Court substituted its judgment for that of the Board. In so doing, the Bankruptcy Court's actions were clearly erroneous and contrary to law. The Bankruptcy Court had to analyze the Board's good faith in light of the Commissioner's emergent actions. Mere financial analysis of the two bids, with the clarity of hindsight, failed to examine the totality of the circumstances."[7]

The district court also determined that because northern New Jersey would have faced a public health emergency without a functioning pediatric care hospital, it was improper for the bankruptcy court to apply the principles of a highest and best offer mechanically. Instead, the court should have taken into account all circumstances faced by United Healthcare, including the fact that it is a charitable institution with a mission to "maintain the legacy of the Children's Hospital," the judgment and expertise of the state regulator who approved the sale, and issuance of the CON and license to St. Barnabas.[8]

Significantly, the district court concluded that the sale process initiated prior to the bankruptcy filing through an RFP was reasonable, and that it was improper for the bankruptcy court to compare the bids made pursuant to the prepetition sale process with those made during the sale hearing.[9] In effect, the district court adhered to the basic rule that once a sale has been held and a winning bidder has been declared, absent fraud or other impropriety, it is improper for the court to consider subsequent bids.

A debtor or trustee may seek court approval of a bid with a lower monetary value if that bid has **fewer contingencies** or contains **certain intangible value**, such as continuing business operations in a small community. Moreover, in certain industries, such as healthcare, courts will take **societal needs** into account.

Similar Considerations for St. Vincent's

Recently, in the St. Vincent's Catholic Medical Centers of New York's Chapter 11 case, the preservation of the healthcare facility and the needs of the community were key considerations in the debtor's decision to sell a facility in a private sale rather than an open auction.[10]

Among the facilities operated by the debtor was St. Vincent's Westchester Hospital (SVW) facility located on approximately 66 acres of land in Harrison, N. Y., of which 37 acres were undeveloped. SVW, which has over 900 employees, provides mental healthcare and substance abuse services to thousands of patients on an inpatient and outpatient basis. It is one of the largest hospitals providing outpatient services for substance abuse and mental healthcare in New York City and the Hudson Valley.[11] According to state and local regulators, the range and volume of services provided by SVW was irreplaceable.[12]

Prior to its bankruptcy filing, the debtor engaged in an extensive marketing process. However, only one purchaser, St. Joseph's Medical Center, had the financial wherewithal to close on an expedited basis and continue to provide all of the debtor's inpatient and outpatient services. In light of the emergent circumstances and the fact that St. Joseph's was the only viable purchaser for SVW's assets, the debtor sought approval of the sale as a private sale, rather than one subject to higher or better offers.[13]

Under the sale, St. Joseph's agreed to acquire SVW's assets for $18 million in cash plus a promissory note in the amount of $6 million and the assumption of approximately $15 million of liabilities regarding employees, suppliers and other secured creditors.[14] Additionally, SVW negotiated a real estate option to reacquire the 37 acres of valuable undeveloped land for $5 million plus other carrying costs, thereby enabling the debtor to market the option to third-party real estate developers or other potential purchasers.

By obtaining approval[15] of the sale of SVW's behavioral health assets pursuant to a private sale, the debtor was able to maintain the ongoing operations of the hospital, thereby supporting the needs of the communities served by the hospital, as well as preserving the jobs of over 900 employees. Also, by separating out the undeveloped land through a purchase option, the debtors preserved the ability to market a very valuable real estate asset.

Results in Other Industries

In the non-healthcare context, consideration of the purchaser's ability to close were determining factors for the court in *In re Bakalis*,[16] where a lower bid was approved.

In *Bakalis*, the debtor's chief asset was a 70 percent to 80 percent controlling interest in Olympian Bank, a small community bank. After extensive marketing, including negotiations with a competitor, Atlantic Bank of New York (Atlantic), and a newly formed entity, Olympian Holdings LLC (Holdings), which was made up of approximately 50 investors, including four officers and directors of Olympian Bank, the Chapter 7 trustee entered into an agreement with Holdings for the sale of the stock for $9.25 million subject to higher and better offers.[17]

After four rounds of bidding, the two highest bidders were Holdings' offer of $10.5 million

structured as a simple stock purchase, with regulatory approval as the only material contingency to closing; and Atlantic's bid for $11.2 million, which was structured as a sale/merger transaction. To deal with the risk of litigation over the merger, Atlantic offered an indemnity fund in the amount up to $500,000 for litigation expenses. Atlantic's offer also contained various additional contingencies, such as a pending litigation clause, obtaining all necessary approvals for the merger and a material adverse change clause.

The trustee recommended approval of Holdings' lower bid based on the numerous contingencies in the Atlantic offer. The trustee also was concerned about the potential disruption to Olympian Bank's business resulting from a sale to Atlantic, since Atlantic was a competitor and there would likely be key management defections and litigation over the merger.

After a two-day hearing, the court approved the sale to Holdings despite the fact that it was for a lower dollar amount. While the court recognized the trustee's duty to maximize the value of the estate, the court noted that "this usual outcome overlooks a fundamental truism, i.e., a 'highest' bid is not always the 'highest and best' bid."[18] The court also recognized that a trustee, as a conservator of the estate, must be risk adverse.[19]

In approving the lower bid, the court recognized that the trustee carefully weighed the competing bids and demonstrated that the risks and delay of closing a merger by Atlantic were real.[20]

Other courts also have considered a bidder's ability to close quickly and other intangibles such as job preservation.

For example, after conducting a 20-hour auction, Schutt Sports Inc.,[21] a manufacturer of football helmets, selected the last bid submitted by Kranos Intermediate Holding Corp. (Kranos), which netted the estate $33.1 million, as the winning bid instead of one from Rawlings Sporting Goods (Rawlings), which netted the estate approximately $1 million more.[22]

In addition to the payment of $7.5 million to critical trade vendors, other trade vendors and 503(b)(9) claims, Kranos agreed to waive all conditions to closing and close immediately upon entry of an order approving the sale. In addition, Kranos agreed to guarantee one year of employment to all of the debtor's employees located in two small towns in Illinois, where the debtor is one of the largest employers; and Easton, Pa., where the debtor is the fifth largest employer.

Kranos also committed to do business with the debtor's critical trade vendors for a period of at least six months. Kranos further agreed to reduce its target for any adjustments to the working capital adjustment and assume all employee benefit plans.

The ability of Kranos to close immediately was essential to the debtor, because it provided certainty of a closing and eliminated the debtor's need to continue to draw on its line of credit at the rate of $100,000 to $150,000 per day. While Rawlings' final bid netted approximately $1 million more to the estate, Rawlings' closing date was approximately nine days later.

In light of the importance of an immediate closing and the fact that the Kranos bid guaranteed employment for almost 400 employees, the debtor determined that the Kranos bid was the highest and best bid.

Rawlings objected. In overruling the objection and approving Kranos as the winning bidder, the court agreed that Kranos was the best bid in light of the elimination of all closing conditions, the immediate closing, changes to the working capital targets, elimination of all contingencies, payment of all cure costs and the guaranty of jobs.[23] The court also noted that the retention of existing employees is a factor that has come into play more frequently in recent years and that "saving jobs is a very tangible thing…."[24]

Bidding Strategy

Given a court's ability to consider non-monetary terms when determining which bid is highest and best, purchasers participating in bankruptcy sales must be careful, as part of their bidding strategy, to eliminate any unnecessary contingencies that may impact the value of their bid.

In addition, purchasers may be able to use non-monetary terms to their advantage to increase the value of their bid or to obtain the support of key constituencies, whether it is suppliers, employees or others.

For debtors and their creditors, they should make sure bidding procedures allow them to consider these non-monetary factors when determining which bid to select as the highest or otherwise best bid.

1. 11 U.S.C. §363(b).
2. *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1071 (2d Cir. 1983).
3. *In re Landscape Properties Inc.*, 100 B.R. 445, 447 (Bankr. E.D. Ark. 1988) (In liquidation cases, it is 'legally essential' to approve the highest offer, assuming the bids and bidders are similar in all other requests).
4. 1997 WL 176574, No. 97-1159 (D. N.J. March 26, 1997).
5. Id. at *6.
6. Id. at *3; *In re United Healthcare Sys. Inc.*, No. 97-21785 (WFT) at 9, 15 (Bankr. D.N.J. filed March 5, 1997).
7. 1997 WL 176574 at *6.
8. Id. at *5-6.
9. Id. at *6 (citations omitted).
10. *In re St. Vincent's Catholic Medical Centers of New York*, No. 10-11963 (CGM) (Bankr. S.D.N.Y. April 14, 2010).
11. Id. (Debtors' Motion for an Order Approving the Sale of Debtors' Behavioral Health Assets dated Aug. 25, 2010 [Docket #799] ("Sale Motion") at 3, 8).
12. *St. Vincent's* (Debtors' Omnibus Response to Various Objections to the Sale dated Oct. 4, 2010 [Docket #960] ("Response") at 3 n. 3, 9-10.
13. Sale Motion at 4, 29.
14. Response at 4-6.
15. *St. Vincent's* (Order Approving Sale dated Oct. 12, 2010 [Docket #1011]).
16. 220 B.R. 525 (Bankr. E.D. N.Y. 1998).
17. Id. at 528-29.
18. Id. at 533.
19. Id. at 532.
20. Id. at 532, 536.
21. *In re Schutt Sports Inc.*, No. 10-12795 (KJC) (Bankr. D.Del. Sept. 6, 2010).
22. Id. (Transcript of Hearing dated Dec. 15, 2010 ("Transcript") at 38-40).
23. Transcript at 105.
24. Id. at 103.

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