

To: Our Clients and Friends

July 14, 2014

## Federal Antitrust Laws: A New Tool to Prohibit Pre-Petition Coordination Among Creditors?

**Who Should Read This?** *Anyone that deals in distressed debt, and in particular anyone that acquires distressed or defaulted bond debts.*

**Why is this Alert Important?** *If you deal in or acquire distressed bond debt, an aggressive obligor may seek to turn the tables on you. The theories described in this Client Alert may impede your ability to negotiate collectively with your fellow bondholders – which is one of the best arrows in your quiver. Moreover, this Client Alert deals with evolving law in the 11th Circuit (covering Alabama, Florida and Georgia). If your obligor is located there, please pay particular attention, as this law will likely apply to your dealings with that obligor.*

The antitrust laws generally prohibit any agreement or conspiracy that unreasonably restrains trade. A typical antitrust violation is a conspiracy among competitors to fix the prices for goods or services offered in the open market.

But what effect do the antitrust laws have on efforts by *creditors* to coordinate and negotiate collectively with an obligor regarding the repayment of debt? These negotiations between creditors and obligors are not uncommon; creditors' committees routinely form both formally and informally, both prior to and after a bankruptcy filing. Indeed, participation by creditors' committees in a bankruptcy case is specifically contemplated by the Bankruptcy Code and is often critical to maximize creditor recoveries.<sup>1/</sup>

Despite this bedrock principle, a recent string of opinions from the Eleventh Circuit casts doubt on the ability of creditors to lawfully coordinate, *pre-petition*, in their negotiations with obligors. In *CompuCredit Holdings Corp. v. Akanthos Capital Mgmt., LLC*, 916 F. Supp. 2d 1326 (N.D. Ga. 2011), CompuCredit Holdings Corporation ("*CompuCredit*")<sup>2/</sup> sued the holders of seventy percent of its outstanding convertible senior notes (the "*Noteholders*"), alleging violations of Section 1 of the Sherman Act because the Noteholders (i) coordinated to boycott CompuCredit's attempt to repurchase its notes at a discount, and (ii) collectively sued CompuCredit for purported fraudulent

<sup>1/</sup> Prior challenges to collective actions of creditors in the bankruptcy context have been rejected. See *United Airlines, Inc. v. U.S. Bank, N.A.*, 406 F.3d 918 (7th Cir. 2005) (holding that bankruptcy proceedings are collective in nature and therefore it is illogical to apply antitrust laws to prohibit collective action); *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1052 (2d Cir. 1982) (characterizing debtor's antitrust claims against collective group of creditors as "border[ing] on the frivolous").

<sup>2/</sup> On November 28, 2013, CompuCredit changed its name to Atlanticus Holdings Corporation. For ease of reference, this alert continues to refer to it as CompuCredit.

transfers. The District Court for the Northern District of Georgia rejected CompuCredit's Sherman Act claims. A three-judge panel of the Eleventh Circuit affirmed the District Court.<sup>3/</sup>

If this was the end of the story, we wouldn't be writing this. After all, courts have long rejected efforts by plaintiffs to beat up their creditors using the antitrust laws.<sup>4/</sup> But instead, after rehearing *en banc*,<sup>5/</sup> the Eleventh Circuit affirmed the District Court's ruling without opinion but more importantly, *vacated* the three-judge panel's prior decision. In short, the entire *en banc* panel split evenly on whether CompuCredit had an antitrust claim under the Sherman Act based on the Noteholders' conduct.<sup>6/</sup> In other words, several appellate judges of the Eleventh Circuit could view an antitrust claim against a pre-petition noteholders' committee as viable.

We do not think that the *CompuCredit* decisions change the landscape in bankruptcy at all – there are specific Bankruptcy Code provisions authorizing collection action by committee.<sup>7/</sup> But *pre-bankruptcy*, the Eleventh Circuit's *en banc* ruling has created great uncertainty regarding whether creditors can lawfully coordinate in negotiations with obligors for the repayment of debt. If you are preparing to form an informal committee of creditors (or if you are the subject of one!), and especially if the obligor is located in Alabama, Florida, or Georgia, then this may require a rethinking of your strategy.

### **Background on Antitrust Law**

The most prominent and sweeping fair competition law in the United States is the Sherman Antitrust Act. The Sherman Act was promulgated in 1890 and forms the backbone of American antitrust law and fair competition policy. The Sherman Act broadly prohibits two types of conduct: Section 1 prohibits contracts, combinations, and conspiracies “in restraint of trade;” and Section 2 prohibits monopolization or attempts to monopolize. See 15 U.S.C. §§ 1, 2.

Section 1 seeks to promote competition by preventing collusion amongst competitors. Although the Sherman Act does not define conduct that is “in restraint of trade,” courts have developed two analytical tools to determine whether conduct constitutes a Section 1 violation: (i) the rule of reason and (ii) the *per se* rule. The rule of reason examines the conduct and intent of the actors to determine whether, taking into account the totality of the circumstances, the challenged conduct promotes or suppresses competition. However, certain practices, such as price fixing, group boycotts/agreements not to deal, and market division, are considered so inherently anticompetitive that they are *per se* violations of Section 1, regardless of the intent of the parties or the actual effect of the conduct on the market. It was under the Sherman Act's prohibition on collective action in restraint of trade that CompuCredit brought suit against the Noteholders.

Violations of the Sherman Act can result in both criminal and civil consequences, including criminal fines and prison time and civil actions for treble (triple) damages.

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<sup>3/</sup> *CompuCredit Holdings Corp. v. Akanthos Capital Mgmt., LLC*, 661 F.3d 1312 (11th Cir. 2011) *reh'g en banc granted, opinion vacated*, 677 F.3d 1042 (11th Cir.) *and on reh'g en banc*, 698 F.3d 1348 (11th Cir. 2012), *cert. denied*, 133 S. Ct. 2736 (2013).

<sup>4/</sup> See footnote 1, above.

<sup>5/</sup> An *en banc* rehearing takes place when all of the appeals judges in the Circuit decide to hear a matter, instead of letting the initial ruling by three appellate judges stand.

<sup>6/</sup> *CompuCredit Holdings Corp. v. Akanthos Capital Mgmt., LLC*, 698 F.3d 1348 (11th Cir. 2012) *cert. denied*, 133 S. Ct. 2736 (2013).

<sup>7/</sup> See, e.g., 11 U.S.C. § 1102 (authorizing formation of committees); 11 U.S.C. § 1109 (listing creditors' committees and equityholders' committees as parties in interest in Chapter 11 cases).

## *The CompuCredit Decisions*

The *CompuCredit* rulings arose out of a single set of facts. CompuCredit issued two series of long-term convertible promissory notes that, after issuance, were freely traded on the secondary market. Thereafter, the Noteholders, consisting of several hedge funds, collectively acquired approximately seventy percent of the CompuCredit notes on the secondary market.

In December 2009, CompuCredit announced plans to issue a \$25 million dividend to stockholders and to spin off its “microloan” business. The Noteholders, unhappy with this, sued CompuCredit in federal district court seeking a preliminary injunction to prohibit the issuance of the dividend and spinoff on the basis that CompuCredit was insolvent and these actions would constitute a fraudulent transfer under the Uniform Fraudulent Transfer Act (“*UFTA Litigation*”). The District Court denied the Noteholders’ request for the preliminary injunction. CompuCredit thereafter issued the dividend. Undeterred, the Noteholders amended their complaint to seek damages arising from CompuCredit’s issuance of the dividend.

In January 2010, and after issuance of the dividend, CompuCredit offered to repurchase up to \$160 million of its outstanding notes at or near the then-current trading price (approximately 35-50% of par). While CompuCredit did successfully repurchase a number of its notes, the Noteholders did not participate in the repurchase. Instead, the Noteholders demanded that CompuCredit repurchase the notes at par.

In response to the commencement of the *UFTA Litigation* and the Noteholders’ refusal of CompuCredit’s repurchase offer, CompuCredit sued the Noteholders in a separate action alleging that the Noteholders were horizontal competitors in the secondary market for CompuCredit notes and violated Section 1 of the Sherman Act by conspiring to inflate the prices of CompuCredit notes, filing the “sham” *UFTA* lawsuit, boycotting CompuCredit’s tender offer to repurchase the notes at market price (rather than face value), and engaging in price fixing by jointly demanding that any repurchase of the notes must be at par (the “*Antitrust Litigation*”).

Specifically, CompuCredit alleged that the Noteholders violated the *per se* prohibition on group boycotts and price fixing when they jointly refused to accept the tender offer and indicated that they would not accept any offer to repurchase the notes at less than face value. In response, the Noteholders claimed that the *per se* prohibition on group boycotts and joint action by competitors does not apply when the alleged competitors are creditors jointly negotiating a pre-existing debt with the obligor. Instead, the Noteholders alleged that joint activity by creditors is commonplace and pro-competitive because it maximizes repayment of existing debt, makes possible pre-bankruptcy workouts, and generally reduces the cost of borrowing in the future.

Meanwhile, in the *UFTA Litigation*, CompuCredit asserted counterclaims against the Noteholders for the same alleged violations of the Sherman Act as asserted in the *Sherman Act Litigation*.

In the *Antitrust Litigation*, the District Court granted judgment on the pleadings in favor of the Noteholders holding that collective action of creditors in an effort to maximize repayment under competitively determined contracts is not the type of conduct to which the Sherman Act applies. In the *UFTA Litigation*, the District Court dismissed CompuCredit’s Sherman Act counterclaims for the same reasons it granted judgment on the pleadings in the *Antitrust Litigation*. CompuCredit separately appealed the District Court’s rulings on the Sherman Act claims in the *Antitrust Litigation* and the *UFTA Litigation*.

On appeal from the *Antitrust Litigation*, a three-judge panel of the Eleventh Circuit affirmed the District Court’s grant of judgment on the pleadings with respect to the Sherman Act claims, holding that the Noteholders acts did not constitute a violation of the Sherman Act and further clarifying that joint action by creditors against an obligor are factually dissimilar to cases in which competitors conspire to boycott, price fix, or otherwise restrict future market prices.

Unsatisfied with this ruling, CompuCredit petitioned for rehearing *en banc*. (An *en banc* rehearing is when all of the appellate judges in the Circuit, instead of just a three-judge panel, hears the case.) The Eleventh Circuit granted the request to hear the matter *en banc*. As a result, the three-judge panel decision was vacated. CompuCredit further moved to consolidate the *en banc* appeal from the Antitrust Litigation with its appeal of the dismissal of its Sherman Act counterclaims arising from the UFTA Litigation. The Eleventh Circuit denied the motion to consolidate and stayed the appeal of CompuCredit's counterclaims pending the *en banc* decision. Sitting *en banc*, the Eleventh Circuit was evenly divided on whether a claim could properly be stated under Section 1 of the Sherman Act based on the Noteholders' collective conduct. That "stalemate" resulted in the District Court's grant of judgment on the pleadings in the Antitrust Lawsuit being affirmed without opinion.

As a result of the Eleventh Circuit's affirmance of the District Court's ruling in the Antitrust Litigation without opinion, and the Eleventh Circuit's refusal to consolidate the two appeals, CompuCredit was able to pursue its appeal of the District Court's dismissal of CompuCredit's Sherman Act counterclaims arising from the UFTA litigation. Although again addressing the merits of the Sherman Act claims, the Noteholders also moved to dismiss the appeal on grounds that the affirmance of the District Court's dismissal of the Sherman Act claims was *res judicata* and barred CompuCredit from asserting the same Sherman Act claims in this subsequent appeal.

The new three-judge panel of the Eleventh Circuit considering this second appeal affirmed the District Court's dismissal of CompuCredit's Sherman Act counterclaims on grounds that the District Court already ruled on these issues in the Antitrust Litigation and that relitigation of these claims was barred by *res judicata*. The Eleventh Circuit did not, however, address the merits of CompuCredit's Sherman Act claims. In a separate concurring opinion, Judge William Pryor, who sat on the original three-judge panel of the Eleventh Circuit that ruled that the Noteholders' conduct did not implicate the Sherman Act, reasserted his opinion that, although the original panel decision was vacated, joint action by creditors against a common obligor is not a Sherman Act violation, but rather serves pro-competitive purposes.

### ***Significance of the CompuCredit Decisions***

The *CompuCredit* opinions represent a potential shift in the understanding and application of antitrust laws to the pre-bankruptcy activity of creditors. Creditors routinely coordinate, form committees, hire common counsel, and negotiate as a collective with obligors and other interested parties. Often, the primary focus is the level of creditor recovery—or, to put it in terms of the *CompuCredit* cases, the price at which creditors' claims may be repaid. The apparent conclusion of half of the judges sitting *en banc* for the Eleventh Circuit, if ultimately adopted, that the coordination of creditors to negotiate repayment of debt may violate Section 1 of the Sherman Act, would deal a serious and potentially lethal blow to the ability of creditors to organize in negotiations with obligors to maximize recovery on debts lawfully owed to them. Until the Eleventh Circuit or other courts have occasion to revisit this issue, there will be significant uncertainty as to the legality of creditor committee formation, and committee efforts to negotiate collectively with obligors.

### ***Takeaways***

Restructuring activity is at a lull in today's economic climate. But for companies that are troubled, an out-of-court solution is almost always better, from the company's perspective and for creditors as well. Out-of-court workouts avoid the delay, additional costs, and uncertainty of formal bankruptcy cases – these factors all harm a company's going concern value and thus impair potential creditor recoveries. Yet if obligors can stave off *pre-bankruptcy* creditors' committees by threatening antitrust claims, the efficient out-of-court workout is at risk.

Parties dealing in bond debt should be aware of this odd series of rulings from the Eleventh Circuit, and be ready for another obligor like CompuCredit taking the offensive, by trying to use the Sherman Act to prevent creditors from collective pre-petition bargaining.

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A full list of Bryan Cave's professionals may be found at [www.bryancave.com](http://www.bryancave.com). To discuss this topic further, please speak to the authors below or to your other contact within the firm:

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