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Outside Counsel

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Specific Disclosures for Auctions

ellers engaged in corporate and real property auctions should take note of a recent decision by the U.S. District Court for the Southern District of New York in which a losing bidder's fraud claims against the seller of a commercial high-rise building in midtown Manhattan were allowed to proceed.

In Solow v. Conseco Inc., defendant Conseco Inc. (Conseco), through its broker Eastdil Realty Company LLC (Eastdil), initiated an auction of the General Motors Building pursuant to a Bankruptcy Court order permitting it to sell the building "for the best available price." Potential purchasers were required to execute a confidentiality agreement in which Conseco expressly reserved the right, in its sole discretion, to terminate discussions with any bidder at any time. On behalf of Conseco, Eastdil also sent out invitations to potential bidders specifying detailed procedures and deadlines for the submission of first and second round bids. In addition, the second-round bid letter contained a disclaimer that the building's owner "reserves the right, in its sole and absolute discretion, to accept or reject any offer for any reason.'

Sheldon H. Solow was selected for both first- and second-round bidding. After executing the confidentiality agreement, Mr. Solow submitted timely first and final bids, eventually offering a bid of \$1.4 billion, which Mr. Solow alleged was the highest bid. However, the building was ultimately sold to Harry Macklowe, who allegedly submitted his bid after the specified deadline and in contravention of a number of other auction rules, whose previous "final" bid was \$35

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million less than Mr. Solow's, and who was given an additional opportunity to match Mr. Solow's bid.

Mr. Solow brought suit in the Southern District of New York, asserting claims for breach of duty to hold a fair auction, fraud, promissory estoppel, and unjust enrichment, and seeking a declaratory judgment declaring that the sale to Mr. Macklowe was void as contrary to public policy. Although Mr. Solow's claims for promissory estoppel and unjust enrichment, as well as his request for a declaratory judgment, were denied, Judge Barbara S. Jones refused to dismiss the remaining claims.

While the case was not decided on the merits, that it was allowed to proceed at all should raise concerns for sellers who have engaged in or intend to engage in similar auctions. In particular, the court's decision emphasizes that a contract provision giving the seller absolute discretion to accept or reject bids may not adequately protect sellers who deviate from the rules of the auction.

Duty to Hold a Fair Auction

A noteworthy aspect of the Southern District's decision in *Solow* is that it is one of only a handful of New York cases to consider the fairness of property or business auctions. Because case law concerning a seller's duty to conduct a fair auction is surprisingly silent, in making his case Mr. Solow relies in large part on public policy considerations, citing to the general proposition in New

York law that "[a]uction sales should be conducted with full and fair opportunity for competition among bidders, and that "[a]ny conduct, artifice, agreement, or combination, the purpose and effect of which is to stifle fair competition and chill the bidding, is contrary to public policy and will cause the sale to be set aside."²

In his briefs, Mr. Solow also relies on Valeo Engine Cooling Inc. v. Atkinson Co. of Cal,³ one of the few reported cases to explicitly, albeit briefly, treat the issue of the fairness of auctions. There, the First Department allowed a potential buyer's claims against a seller of a subsidiary to proceed where the potential buyer alleged that the seller had induced it into spending nearly \$300,000 investigating and evaluating the subsidiary, only to unfairly use the potential buyer's offer as a "foil" to get a higher bid. Citing no precedent, the court concluded that "once the parties agreed to a private auction to select potential purchasers who submitted written bids, the auction had to be conducted fairly pursuant to its terms."4 Thus, as Mr. Solow argues, Valeo may indeed suggest that once a seller agrees to a private auction, that auction must be conducted fairly pursuant to its terms.

Specific Disclaimers

The more interesting point to make concerning the court's decision in *Solow* relates to the role of specific disclaimers. In its motion to dismiss the complaint, defendant Conseco argues that where an owner has expressly reserved its right to conduct the sale process in any manner or "to accept or reject any offer for any reason," that reservation of rights precludes the existence of any duty to conduct an auction, fair or otherwise.

It is a well-settled principle of contract law that while "exculpatory provisions drawn in broad and sweeping language [are] not given effect," parties "may contract away their liability...on the condition that their intention be expressed clearly and in unequivocal terms."5

In the auction context, the role of specific disclaimers was addressed by the First Department in Banner Industries Inc. v. Schwartz, where the court upheld the dismissal of a complaint by an unsuccessful bidder in an auction for the sale of two corporate divisions. The bidder claimed that he was induced to participate in the auction by the seller's fraudulent misrepresentations regarding the fairness of the auction, when in fact the seller intended to sell, and did in fact sell, the divisions to a preferred third party. The court held that the complaint was properly dismissed "on the ground that the disclaimers were sufficiently specific to bar any claim of reliance on oral misrepresentations."7

In other contexts, it is equally clear that a specific disclaimer may preclude liability. For example, in Danann Realty Corp. v. Harris,8 the leading case on specific disclaimers, the Court of Appeals dismissed plaintiff's claim that he had been fraudulently induced to enter into a contract because of defendant's false representations, holding that because plaintiff had signed a specific disclaimer stipulating that the seller had not made any representations not embodied in the contract, his allegations were destroyed.9 The court observed that while a general merger clause would not have warranted dismissal, the presence of a specific disclaimer was "inconsistent with the contention that plaintiff relied upon the misrepresentation, and was led thereby to make the contract."10

Relying on Dannan, numerous courts have similarly declined to impose liability on a party where a contractual provision specifically addressed and negated the other party's claim. For example, in Goldberg v. KZ 72nd, 11 a prospective purchaser of two residential units claimed that he had been fraudulently induced into entering a contract for two parking spaces, claiming that he had relied on various oral representations concerning the spaces that turned out not to be true. The court dismissed the cause of action, noting that the offering plan's restrictions concerning the parking spaces were clear, and because the purchase agreements specifically disclaimed any reliance by the plaintiff upon any written or oral representations other than those in the offering plan, the disclaimers were "sufficiently specific to bar reliance upon the alleged oral misrepresentations."12

Indeed, even Valeo suggests that a seller involved in an auction may be able to escape liability by including specific disclaimers in the

bidding documents. As noted above, in Valeo a bidder for the purchase of a subsidiary company brought claims for breach of contract, breach of the duty to hold a fair auction, and unjust enrichment against the seller after the seller rescinded its acceptance of the bidder's offer. There, as in Solow, the bidding documents expressly reserved the seller's right to accept or reject any offer in its absolute discretion. Nevertheless, the court held that because the bidding documents did not expressly reserve the seller's right to rescind an acceptance, the bidder's breach of contract claim could proceed.

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Practical Considerations

An important lesson to take away from these cases is that where the auction procedures contain a specific disclaimer addressing the very matter that is the subject of an unsuccessful bidder's grievance, the bidder cannot prevail. These basic tenets are confirmed in everyday commercial real property practice where sale contracts typically contain a long list of disclaimers. Thus, sellers involved in private auctions should take care to include disclaimers that are as detailed and specific as possible. Specific disclaimers that would have helped Conseco in the General Motors Building auction include:

• "Neither Seller nor Broker is making any representation or warranty as to the manner in which the sale process will be managed."

- "Seller may select the winning bid in its discretion and may consider the reputation, including history of litigation, of the bidder, and the seller's judgment as to the ability of the bidder to close the sale."
- "Seller reserves its rights to sell to a favored bidder or a bidder with which it has other existing or potential business or personal relationship, whether or not such bidder has submitted the highest bid."
- "After bids are submitted, Seller may permit a preferred buyer or buyers to make matching or higher bids without permitting all bidders to do so. Accordingly, a bidder may become a 'stalking horse' or 'foil'13 for Seller to give Seller leverage to raise a favored bidder's price."
- "No obligation to sell shall be binding on Seller unless and until a written contract of sale is signed and delivered by Seller. Seller may rescind any oral acceptance of a winning bid prior to the execution and delivery of such contract of sale for any reason including the receipt of a subsequent higher bid, whether or not such subsequent bid was made within the time frames set forth in the bidding documents."

1. 06-Civ-5988 (S.D.N.Y. Jan. 11, 2008).

2. Plaintiff's Mem. of Law in Opp. to Defendant's Motion to Dismiss the Complaint at 7, citing 7 New York Jurisprudence 2d Auctions and Auctioneers §23 (1997).
3. 240 AD2d 176 (1st Dept. 1997).

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- 5. Gross v. Sweet, 49 NY2d 102, 110 (1979) (internal
- citation omitted).
 6. 204 AD2d 190 (1st Dept. 1994). See also Banner Industries Inc. v. Schwartz, 181 AD2d 479 (1st Dept. 1992).
 7. Banner, 204 AD2d at 190. The opinion does not quote the specific contract provisions.

5 NY2d 317, 320-21 (1959).

10. Id. at 322 (internal citation omitted). 11. 171 AD2d 525, 527 (1st Dept. 1991).

13. See Valeo, 240 AD2d 176 (1st Dept. 1997).

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