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BANKRUPTCY SECTION 363(b) SALES: MARKET TEST PROCEDURES AND HEIGHTENED SCRUTINY OF EXPEDITED SALES MAY PREVENT ABUSES AND SAFEGUARD CREDITORS WITHOUT LIMITING THE POWER OF THE COURTS

INTRODUCTION

On April 30, 2009, Chrysler LLC filed for Chapter 11 bankruptcy protection after failing to reach an agreement with lenders to restructure its debt.¹ President Barack H. Obama promised a quick bankruptcy process, with one senior official predicting that the process could be completed within thirty to sixty days.² The government's promises were fulfilled on May 31, 2009, when Southern District of New York Bankruptcy Court Judge Arthur Gonzalez issued a decision approving a sale of the corporation's main business assets to a newly formed entity, "New Chrysler."³ After an expedited appeal, the Second Circuit Court of Appeals issued a bench decision affirming the Bankruptcy Court on June 5, 2009, and released a full written decision two months later.⁴ Later that year, Chrysler's "Big Three"⁵ brother, General Motors, Corp., filed for Chapter 11.⁶ Similar to Chrysler, General Motor's path through bankruptcy took approximately one month.⁷ As was the case in *Chrysler*,⁸ the debtor in *General Motors*, with the approval and order of the Court, used Bankruptcy Code (the Code) § 363(b)⁹ to sell the General Motors assets to a new entity, "New General Motors."¹⁰ Further, in both cases, the federal government was highly involved, with the Treasury Department (Treasury) providing financing for the bankruptcies and the government—along with the United Auto Workers Union—acquiring ownership of a large portion of the new entities.¹¹

1. See *In re Chrysler LLC (Chrysler I)*, 405 B.R. 84, 87–88 (Bankr. S.D.N.Y. 2009).

2. Chris Isidore, *Chrysler Files For Bankruptcy*, CNNMONEY.com, May 1, 2009, http://money.cnn.com/2009/04/30/news/companies/chrysler_bankruptcy/index.html.

3. *In re Chrysler I*, 405 B.R. at 84–92, 113.

4. *In re Chrysler LLC (Chrysler II)*, 576 F.3d 108, 109, 127 (2d Cir. 2009).

5. The "Big Three" refers to the three major American automotive companies: General Motors, Ford, and Chrysler.

6. *In re General Motors Corp.*, 407 B.R. 463, 479 (Bankr. S.D.N.Y. 2009) ("On June 1, 2009 . . . GM filed its chapter 11 petition in this court.").

7. See *id.* at 520 (approving the 363(b) sale of the assets of General Motors to a purchaser "New GM" on Sunday, July 5, 2009).

8. See *Chrysler I*, 405 B.R. at 87.

9. 11 U.S.C. § 363(b) (2006); discussion *infra* Part II.

10. *In re General Motors*, 407 B.R. at 473.

11. Mike Ramsey & Lizzie O'Leary, *Fiat Said to Buy Chrysler Assets Today to Form New Automaker*, BLOOMBERG.COM, June 10, 2009, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aAB9jCmPBUQU> ("Chrysler Group LLC, will be owned 20 percent by Turin, Italy-

In all likelihood, neither General Motors nor Chrysler could have survived a long, drawn-out bankruptcy process.¹² Some commentators argue the short processes and use of § 363(b) sales were vital to prevent the companies' collapse and a resulting loss of the production, jobs, and stability that they provide.¹³ However, even if the quick sale of the two auto giants was the correct and legal course of action, questions remain as to whether the *Chrysler* and *General Motors* cases will serve as precedent for a more liberal use of these expedited sales procedures.¹⁴ Further, if the use of § 363(b) sales does increase, what consequences await? And if these consequences are negative or undesirable, can anything be done to mitigate them while preserving the flexibility and benefits the use of such sales provides bankruptcy judges and filers alike?

Despite the many conveniences and benefits of § 363(b) sales, additional procedural safeguards should be put in place to prevent abuses from occurring. This note proposes a robust market test for § 363(b) sales that requires: 1) disclosure of sales terms; 2) adequate time for market

based Fiat, 9.85 percent by the U.S., 2.46 percent by Canada and 67.69 percent by a United Auto Workers union retiree health care trust fund. The U.S. and Canadian governments financed the sale with \$2 billion.”); Emily Chasan & Phil Wahba, *GM Asks for Bankruptcy Sale in 30 Days*, REUTERS, June 1, 2009, available at <http://www.reuters.com/article/businessNews/idUSTRE5507X420090601> (“Under a government-backed restructuring plan, the Obama administration would take a 60 percent stake in the newly-formed company made up of GM’s most profitable assets. The UAW would have a 17.5 percent stake, the Canadian government would own about 12 percent and GM bondholders would receive about 10 percent.”).

12. See generally Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531, 544 (2009) (noting that “liquidating a company the size of Chrysler would have cost millions of dollars”). The U.S. Treasury and Canadian government officials also wanted an “expedited” process to “preserve the value of the business, restore consumer confidences, and avoid the costs of a lengthy chapter 11 process.” *Id.* at 536–37.

13. See A. Joseph Warburton, *Understanding the Bankruptcies of Chrysler and General Motors: a Primer*, 60 SYRACUSE L. REV. 531, 567–68 (2010) (discussing the rapid erosion of assets and “going concern value” of Chrysler LLC in the *Chrysler* case). As of early 2009, “General Motors employed approximately 235,000 employees worldwide” and had assets of \$82 billion. *In re General Motors*, 407 B.R. at 475. Chrysler employed approximately 55,000 employees and had revenue of nearly \$50 billion for the year prior to its bankruptcy petition. *In re Chrysler LLC (Chrysler I)*, 405 B.R. 84, 88–89 (Bankr. S.D.N.Y. 2009).

14. Multiple commentators have questioned the state of bankruptcy law after *General Motors* and *Chrysler*. See, e.g., Barry E. Adler, *A Reassessment of Bankruptcy Reorganization After Chrysler and General Motors*, 18 AM. BANKR. INST. L. REV. 305, 305 (2010).

The recent bankruptcy cases of *Chrysler* and *General Motors* were successful in that they quickly removed assets from the burden of unmanageable debt amidst a global recession, but the price of this achievement was unnecessarily high because the cases established or buttressed precedent for the disregard of creditor rights. As a result, the automaker bankruptcies may usher in a period where the threat of insolvency will increase the cost of capital in an economy where affordable credit is sorely needed.

Id.; Robert M. Fishman & Gordon E. Gouveia, *What's Driving Section 363 Sales After Chrysler and General Motors?*, 19 NORTON. J. BANKR. L. & PRAC. 4, Art. 2 (2010) (“Do the *Chrysler* and *General Motors* cases represent a new paradigm in which preserving going concern value and jobs take precedence over the protections that Chapter 11 has traditionally afforded to creditors?”) (citations omitted).

players to bid on the asset; and 3) centralized review of competing bids. Additionally, where “time is of the essence” and a market test is either impossible or impractical, heightened judicial review should substitute for such a test. Part I of this note provides the history of pre-confirmation asset sales in bankruptcy proceedings. Part II compares § 363(b) sales with bankruptcy reorganization plan confirmations and analyzes the benefits and detriments of each. Part III proposes a robust market test procedure to be implemented in § 363(b) sales and heightened scrutiny for “time is of the essence” sales, where a robust market test is impossible. The note concludes by explaining the significance and drawbacks of this proposal and what future problems may arise in § 363(b) sales.

I. HISTORY OF THE BANKRUPTCY PRE-CONFIRMATION ASSET SALE

Section 363(b), used in both *Chrysler* and *General Motors*, provides a means by which a bankruptcy judge can order a company to sell assets before a bankruptcy plan confirmation is reached.¹⁵ The procedure involves a showing of cause for the sale and courts allow creditors the opportunity to object.¹⁶ The use of these pre-confirmation sales is expressly provided for in 11 U.S.C. § 363(b), enacted in 1978.¹⁷ The provisions of this section of the Code apply equally to a debtor in possession (DIP or debtor) as they do to a trustee.¹⁸ Additionally, the “other than in the ordinary course of business” clause has been read broadly to allow sales of entire business entities.¹⁹

Section 363(b) sales have been used in some of the largest and most well-known bankruptcies, including those of Enron and the two recent

15. 11 U.S.C. § 363(b) (2006).

16. *Id.*

17. 11 U.S.C. § 363(b)(1) states the following:

(b)(1) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, . . .

(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease—

(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and

(ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

Id.

18. For the purposes of § 363, the debtor in possession enjoys the same rights and benefits under the Code as those prescribed to the trustee. *See* 11 U.S.C. §§ 363, 1107, 1108 (2006).

19. *See, e.g., In re General Motors Corp.*, 407 B.R. 463, 489–90 (Bankr. S.D.N.Y. 2009); *In re Chrysler LLC (Chrysler I)*, 405 B.R. 84, 94 (Bankr. S.D.N.Y. 2009); *In re Torch Offshore, Inc.*, 327 B.R. 254 (E.D. La 2005).

automotive manufacturer bankruptcies.²⁰ Academic appraisal of § 363(b) sales has varied, with some advocating for their use as a model to which all large bankruptcies should aspire,²¹ while others have criticized the use of such sales, claiming that they subvert the bankruptcy system and are ripe for abuse.²²

Expedited pre-confirmation sales procedures have a long history in American bankruptcy law, with statutory authority for such sales enacted as early as 1867.²³ The evolution of § 363(b) sales since that time provides meaningful insight into the drafters' purpose and intent in crafting the procedures for these sales.

A. PRE-CONFIRMATION SALE OF ASSETS IN BANKRUPTCY PRIOR TO THE 1978 BANKRUPTCY CODE

The Bankruptcy Act of 1867 provided that the court may order the sale of the estate of the debtor if it finds that it "is of a perishable nature, or liable to deteriorate in value"²⁴ The Second Circuit, in 1913, held that the concept of "perishable" was not only limited to the physical nature of the object but also to the price of the object.²⁵ The Ninth Circuit, using as a standard for determining the validity of a sale the deterioration of monetary value as well as physical deterioration, reached the same result twenty years later in *Hill v. Douglas*, upholding the sale of road-making equipment to prevent repossession.²⁶

20. See, e.g., *Chrysler I*, 405 B.R. at 113, *In re General Motors*, 407 B.R. at 520, *In re Enron Corp.*, 291 B.R. 39, 40 (S.D.N.Y. 2003); see also *The 10 Largest U.S. Bankruptcies*, CNNMONEY.COM, http://money.cnn.com/galleries/2009/fortune/0905/gallery.largest_bankruptcies.fortune/index.html (last visited Dec. 30, 2010).

21. See, e.g., Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153 (2004); Bryant P. Lee, Note, *Chapter 18? Imagining Future Uses of 11 U.S.C. § 363 to Accomplish Chapter 7 Liquidation Goals in Chapter 11 Reorganizations*, 2009 COLUM. BUS. L. REV. 520.

22. E.g., Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 13 (2007); Chad P. Pugatch, Craig A. Pugatch & Travis Vaughan, *The Lost Art of Chapter 11 Reorganization*, 19 U. FLA. J.L. & PUB. POL'Y 39, 58 (2008); Craig A. Sloane, *The Sub Rosa Plan of Reorganization: Side-Stepping Creditor Protections in Chapter 11*, 16 BANKR. DEV. J. 37, 63 (1999); Elizabeth B. Rose, Note, *Chocolate, Flowers, and § 363(b): The Opportunity for Sweetheart Deals Without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 249 (2006) (citing *Administration of Large Business Bankruptcy Reorganizations: Has Competition for Big Cases Corrupted the Bankruptcy System?: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 108th Cong. 15 (2004) (statement of Lynn M. LoPucki)).

23. See Bankruptcy Act of 1867, ch. 176, 14 Stat. 517, 528 (1867).

24. *Id.*

25. *In re Pedlow*, 209 F. 841, 842 (2d Cir. 1913).

26. *Hill v. Douglass*, 78 F.2d 851, 854 (9th Cir. 1935).

It will be conceded that road-making equipment is not within the ordinary concept of perishable property. Yet the courts have been liberal in their construction of this term

In the Chandler Act of 1938 (the Chandler Act), the immediate precursor to the current Code, § 116(3) provided that a sale could be ordered “upon cause shown.”²⁷ This standard was generally read as an extension of the “perishable” concept that existed prior to the Chandler Act and pre-confirmation sales persisted as the exceptional remedy.²⁸ The circuit courts split in their approach to the validity of sales pursuant to § 116(3) of the Chandler Act.²⁹ The Second Circuit took a broad view of the statute and, in *Frank v. Drinc-O-Matic, Inc.*, gave the bankruptcy judge wide discretion in ordering such sales by adopting an abuse of discretion standard.³⁰ In subsequent cases, the court found that varying conditions such as inability of a debtor to redeem property, failure to pass a plan of reorganization, and the wasting away of an asset were appropriate conditions for the ordering of a pre-confirmation sale.³¹

Not all circuits liberally interpreted the Chandler Act.³² The Third Circuit, in *In re Solar Mfg. Corp.*, limited the use of § 116(3) procedures to “emergency” situations, involving an “imminent” loss of assets.³³ That reasoning was even adopted, albeit for only a short period of time, by the Second Circuit in *In re Pure Penn Petroleum Co.*, where the court required a showing of imminent loss to effectuate a sale.³⁴ However, from the 1950s

and have held it to include not only that which may deteriorate physically, but that which is liable to deteriorate in price and value.

Id. (citing *In re Pedlow*, 209 F. 841 (2d Cir. 1913); *In re Inter-City Trust*, 295 F. 495, 497 (9th Cir. 1924)).

27. See *In re Lionel Corp.*, 722 F.2d 1063, 1067–68 (2d Cir. 1983) (citing the Chandler Act of 1938, ch. 575, 52 Stat. 883 (1938)).

28. See *id.* at 1066–67.

29. Compare *In re Sire Plan Inc.*, 332 F.2d 497, 499 (2d Cir. 1964) (approving a sale where the hotel, at the time a skeletal frame, was wasting away), *In re Marathon Foundry and Machine Co.*, 228 F.2d 594, 598 (7th Cir. 1955) (approving the sale of stock where trustee had insufficient assets to redeem the stock), and *Frank v. Drinc-O-Matic*, 136 F.2d 906, 906 (2d Cir. 1943) (approving sale of vending machines where machines were encumbered by liens and trustee had insufficient funds to redeem machines), with *In re Solar Mfg. Corp.*, 176 F.2d 493, 494 (3d Cir. 1949) (denying the sale of business despite record losses and deterioration of real estate values because the sale did not meet “emergency” requirements).

30. See *Frank*, 136 F.2d at 906.

31. See *In re Equity Funding Corp. of America*, 492 F.2d 793, 794 (9th Cir. 1974) (“[T]he market value of Liberty was likely to deteriorate in the near future”); *In re Sire*, 332 F.2d at 499 (“[T]he Trustees’ evidence demonstrated at hearing [that] the partially constructed building is a ‘wasting asset.’”); *In re Marathon*, 228 F.2d at 594 (“The trustees had not sufficient funds with which to redeem the pledged stock.”); *Frank*, 136 F.2d at 906 (“The trustee had no funds with which to redeem the machines, and after six months no plan of reorganization had been proposed.”).

32. See, e.g., *Solar Mfg.*, 176 F.2d at 494–95.

33. *Id.*

34. *In re Pure Penn Petroleum Co.*, 188 F.2d 851, 854 (2d Cir. 1951) (“The debtor here, therefore, was obliged to allege and had the burden of proving the existence of an emergency involving imminent danger of loss of the assets if they were not promptly sold.”). The emergency requirement was then replaced only thirteen years later by the “best interest” test. *In re Sire*, 332 F.2d at 497.

on, courts began to uphold more sales in which the sale was justified as in the “best interest of the [] estate”;³⁵ circumstances that warranted the order of a sale included a likely fall in market value, heavy interest charges and deteriorating stock value.³⁶

Despite the removal of the “perishability” term from the Bankruptcy Act, the circumstances of the above cases indicated that the “perishability” standard remained in place after the adoption of the Chandler Act, whether through the “emergency” or “best interest of the estate” standards.³⁷

B. 1978 BANKRUPTCY CODE, SECTION 363(b) SALES PROCEDURES

The current Bankruptcy Code was enacted in 1978 and became effective for all cases filed after October 1, 1979.³⁸ The Code amended and replaced the Bankruptcy Act.³⁹ The Code provided a bankruptcy judge with the power to order a sale of the debtor’s assets under §§ 363(b) and 363(f).⁴⁰ Section 363(b) gave statutory strength to the use of such sales without the “perishable” standard of the 1867 act or the “upon cause shown” standard of the Chandler Act, requiring only “notice and a hearing” to effectuate a sale.⁴¹ This language, which was more relaxed than the prior enactments, provided little guidance as to the circumstances under which a sale may be approved, or what the procedural safeguards of “notice and a hearing” provided for creditors opposed to the sale actually required.⁴²

C. *IN RE WHITE MOTOR CREDIT CORP.* AND THE “EMERGENCY” DOCTRINE

In *In re White Motor Credit Corp.*, the bankruptcy court interpreted the newly promulgated Code⁴³ as not authorizing a “sale of all or substantially all assets of the estate.”⁴⁴ However, the court “left the [former] ‘emergency’

35. See, e.g., *In re Equity Funding*, 492 F.2d at 794 (“[T]he proposed sale would be in the best interest of the bankrupt estate. Based upon these findings, which are not clearly erroneous, the trial court could properly conclude that there was ‘cause shown’ for the approval pursuant to 11 U.S.C. § 516(3).”); *Frank*, 136 F.2d at 906 (approving sales after concluding that it was “desirable for debtor”).

36. See *In re Sire*, 332 F.2d at 499 (wasting asset likely to deteriorate in value); *In re Equity Funding*, 492 F.2d at 794 (declining value of stock held by trustee); *In re Marathon*, 228 F.2d at 598–99 (discussing how interest charges prevented debtor from being able to redeem stock).

37. *In re Lionel Corp.*, 722 F.2d 1063, 1069 (2d Cir. 1983).

38. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C.).

39. See *id.*

40. See 11 U.S.C. § 363(b), (f) (2006).

41. *Id.*

42. See, e.g., *In re Lionel*, 722 F.2d at 1069; *In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983).

43. See 11 U.S.C. § 363(b).

44. *In re White Motor Credit Corp.*, 14 B.R. 584, 590 (Bankr. N.D. Ohio 1981).

exception⁴⁵ in fact”⁴⁶ The court concluded that an imminent loss of \$40 million in the value of assets of the estate provided the necessary showing of an “emergency” to approve a sale of the assets.⁴⁷ This decision appeared to severely limit courts’ ability to order pre-confirmation sales and to undermine the broad language of the Code.⁴⁸ However, subsequent opinions would expand and more clearly define the extent to which bankruptcy courts could approve pre-confirmation sales.⁴⁹

D. *IN RE LIONEL CORP.* AND THE “GOOD BUSINESS REASON” STANDARD

Despite the absence of guiding language in § 363(b), the Second Circuit, in *In re Lionel Corp.*, found that the Code’s legislative history suggested that the framers intended to require a trustee or debtor to justify the use of a pre-confirmation sale.⁵⁰ However, the court stated that the “perishability” and “emergency” standards that were formerly employed were no longer required.⁵¹ The court held that to properly order a sale pursuant to § 363(b), a “good business reason” for such an order must be provided before the confirmation of a plan of reorganization.⁵² The court listed the following factors as persuasive in finding a business justification for the sale of assets:

[T]he proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value.⁵³

The court found that the underlying asset in the case—stock owned by the corporation—was not wasting, nor was there an “emergency” requiring its sale.⁵⁴ The panel held the sale improper, even though it applied the

45. See discussion *supra* Part I.A.

46. See *In re White Motor*, 14 B.R. at 590.

47. See *id.*

48. See generally *In re White Motor*, 14 B.R. 584; see also 11 U.S.C. § 363(b).

49. See *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983); *In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983).

50. See *In re Lionel*, 722 F.2d at 1069 (“the statute requires notice and a hearing, and these procedural safeguards would be meaningless absent a further requirement that reasons be given for whatever determination is made . . .”).

51. See *id.*

52. *Id.* at 1071.

53. *Id.*

54. See *id.* at 1071–72.

highly deferential abuse of discretion standard.⁵⁵ The court continued that although it sympathized with the bankruptcy court's desire to expedite the proceedings, "[t]he need for expedition, however, is not a justification for abandoning proper standards."⁵⁶ Although the *Lionel* court found no business justification in the case, the decision's central holding—that a debtor or trustee attempting to use a § 363(b) sale must provide business justification for the sale⁵⁷—has provided precedential support for a broadening of the bankruptcy courts' power to authorize such sales.⁵⁸ *Lionel* is currently the standard under which proposed § 363(b) sales are judged.

In the *Chrysler* bankruptcy, the court justified the § 363(b) sale by finding that Chrysler was an asset wasting away in bankruptcy.⁵⁹ Chrysler was shutting down factories and required immense funding merely to sustain operations, and Fiat—the only available purchaser for Chrysler—insisted that the sale be completed within a certain period of time.⁶⁰ In *General Motors*, the fact that the government predicated its financing on the consummation of a quick § 363(b) sale provided a sufficiently “good business reason” to justify the sale.⁶¹ This type of “time is of the essence” justification may be invoked by a debtor requesting that the court approve a sale before the purchaser is able to pull out of the agreement.⁶²

55. *See id.*

56. *Id.* at 1071 (quoting Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 450 (1968)).

57. *Id.*

58. *See, e.g., In re General Motors*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009); *In re Chrysler LLC (Chrysler I)*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009); *In re Global Crossing Ltd.*, 295 B.R. 726 (Bankr. S.D.N.Y. 2003); *In re Medical Software Solutions*, 286 B.R. 431 (Bankr. S.D.N.Y. 2002).

59. *See Chrysler I*, 405 B.R. at 96.

60. *See id.* at 96–97.

The Governmental Entities, the funding sources for the Fiat Transaction, have emphasized that the financing offered is contingent upon a sale closing quickly. Moreover, if a sale has not closed by June 15th, Fiat could withdraw its commitment. Thus, the Debtors were confronted with either (a) a potential liquidation of their assets which would result in closing of plants and layoffs, impacting suppliers, dealers, workers and retirees, or (b) a government-backed purchase of the sale of their assets which allowed the purchaser to negotiate terms with suppliers, vendors, dealerships and workers to satisfy whatever obligations were owed to these constituencies.

Id.

61. *See In re General Motors*, 407 B.R. at 480.

To facilitate the process, the U.S. Treasury and the governments of Canada and Ontario (through their Export Development Canada (“EDC”)) agreed to provide DIP financing for GM through the chapter 11 process. But they would provide the DIP financing *only* if the sale of the purchased assets occurred on an *expedited* basis.

Id. (emphasis in original).

62. *See* Michael J. de la Merced, *U.S. Court of Appeals Upholds Chrysler Sale to Fiat*, N.Y. TIMES, June 6, 2009, at B2 (“Lawyers for Chrysler and the government argued that the sale to Fiat needed to be completed as quickly as possible to preserve its viability and to save thousands of jobs. Fiat can walk away if no agreement is struck by June 15.”).

**E. *IN RE BRANIFF AIRWAYS, INC. AND THE SUB ROSA*
OBJECTION**

Decided the same year as *Lionel*, *In re Braniff* provided that a § 363(b) sale that distributes assets among creditors was inappropriate and constituted a *sub rosa* plan that attempted to bypass the protections of Chapter 11 plan confirmation proceedings.⁶³ In *Braniff*, the debtor attempted to sell its property—which included airplane leases, equipment, terminal leases, airport slots, and other assets—to a new entity, PSA,⁶⁴ in exchange for right to travel on PSA that would be allocated to former creditors, employees, and shareholders.⁶⁵ Of particular importance, the *Braniff* court held that a release of claims or payment of prepetition debts is not a “‘use, sale or lease’ and is not authorized by § 363(b).”⁶⁶ The court did state that “‘certain adjustments in the rights of creditors’ are permitted in § 363(e) ‘to assure ‘adequate protection’” of the interests of secured creditors.⁶⁷ The court went on to hold that “[i]n any future attempts to specify the terms whereby a reorganization plan is to be adopted, the parties and the district court must scale the hurdles erected in Chapter 11.”⁶⁸

This ban on *sub rosa* plans has been extended from § 363(b) sales to settlement agreements in which assets of the estate are distributed.⁶⁹ In *In re Iridium*, the Second Circuit held that a settlement in the course of the bankruptcy proceeding was inappropriate because it distributed assets to prepetition creditors as part of the agreement.⁷⁰ The court found that the settlement allowed the negotiating parties to sidestep the “fair and equitable” standard as well as the “absolute priority rule” of bankruptcy plan confirmations.⁷¹ Although the *Iridium* court did not label the settlement as a *sub rosa* plan, it stated that a settlement cannot be offered to avoid the “strictures of the Bankruptcy Code.”⁷²

63. See *In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983) (“The debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets.”) (emphasis in the original). Many courts find that the use of such tools is improper. See *In re Westpoint Stevens Inc.*, 333 B.R. 30, 51–52 (S.D.N.Y. 2005).

64. See *In re Braniff*, 700 F.2d at 939. The PSA was an entity formed as part of the Braniff Bankruptcy that took possession of the Braniff Airway’s assets in exchange for payoff of debts and allocation of rights to travel on the new airline. See *id.*

65. *Id.* at 939–40.

66. See *id.* at 940.

67. *Id.* at 940 n.2. (“[The court] is aware that the Code provides for certain adjustments pursuant to a valid § 363 transaction in order to provide ‘adequate protection’ to secured creditors.”) (citing 11 U.S.C. §§ 361; 363(e) (1982)).

68. *Id.* at 940 (listing the applicable hurdles as “disclosure requirements” in 11 U.S.C. § 1125, “voting” in 11 U.S.C. § 1126, “best interest of creditors test” in 11 U.S.C. § 1129(a)(7), and the “absolute priority rule” in 11 U.S.C. § 1129(b)(2)(B)).

69. See *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007).

70. See *id.* at 464.

71. *Id.* at 462–65.

72. *Id.* at 464.

In both the General Motors and Chrysler bankruptcies, payouts to prepetition creditors were part of the § 363(b) sales.⁷³ In both cases, the unions received significant shares of the “new” corporations without providing new capital input.⁷⁴ These actions were justified in both cases because the workforce was necessary for the businesses to succeed and the unions would provide significant value to the new corporations.⁷⁵ However, the payouts to the former pension funds in *Chrysler* and *General Motors*, and the shares of the new enterprises given before other creditors were paid out in both cases,⁷⁶ could be interpreted as hallmarks of a *sub rosa* plan, in which the unions, capable of scuttling the new businesses, gained preferential treatment.⁷⁷ In fact, in the *Chrysler* case, this was one basis upon which the Indiana pension fund creditors challenged the propriety of the sale.⁷⁸

73. See *In re General Motors*, 407 B.R. 463, 484 (Bankr. S.D.N.Y. 2009) (discussing the fact that as part of § 363 sale, “New GM” infused capital into retirement fund of union auto workers); *In re Chrysler LLC (Chrysler I)*, 405 B.R. 84, 92 (Bankr. S.D.N.Y. 2009) (discussing how the U.S. government provided funding for workers’ pension fund through infusion of capital and equity in reorganized company).

74. See *In re General Motors*, 407 B.R. at 497–98; *Chrysler I*, 405 B.R. at 99–100.

75. See Adler, *supra* note 14, at 310 (“[T]he payment to VEBA was . . . a prospective expense that assured the company a needed supply of UAW workers, with the union thus portrayed as a critical vendor of labor.”).

76. See *id.*

[In *Chrysler*,] the purchaser, “New Chrysler”—an affiliation of Fiat, the U.S. and Canadian governments, and the United Auto Workers (“UAW”)—took the assets subject to specified liabilities and interests. More specifically, New Chrysler assumed about \$4.5 billion of Chrysler’s obligations to, and distributed 55% of its equity to, the UAW’s voluntary beneficiary employee association (“VEBA”) in satisfaction of old Chrysler’s approximately \$10 billion unsecured obligation to the VEBA (which is a retired workers benefit fund)

Id. at 306.

In General Motors’ case, the purchaser, “New GM,” owned largely by the United States Treasury, agreed to satisfy General Motors’ approximately \$20 billion pre-bankruptcy obligation to the VEBA with a new \$2.5 billion note as well as \$6.5 billion of the new entity’s preferred stock, 17.5% of its common stock, and a warrant to purchase up to an additional 2.5% of the equity; depending on the success of New GM, the VEBA claim could be paid in full. As in Chrysler, the sale was to take place quickly, within weeks, and the sale procedures required that, absent special exemption, any bidder who wished to compete with government-financed entity was to assume liabilities to the UAW as a condition of the purchase.

Id. at 312.

77. See *id.* at 313–15 (sale of underlying assets and distribution to unions deprived creditors of the protections that they enjoy in a traditional reorganization).

78. See *Chrysler I*, 405 B.R. at 97–100.

II. SECTION 363(b) COMPARED TO BANKRUPTCY PLAN CONFIRMATION

A. BANKRUPTCY PLAN CONFIRMATIONS

A Chapter 11 plan confirmation is a relatively democratic process, requiring a debtor to propose a reorganization/distribution plan and work with creditors to obtain their willing approval.⁷⁹ Sales of the entire business or sales of major business units may be part of the proposed plan.⁸⁰ The debtor has a period of exclusivity during which it alone may propose plans to the creditors,⁸¹ and this period may be extended by petition to the trial judge.⁸² During the plan confirmation period, the debtor may obtain exit financing⁸³ or an alternative to financing,⁸⁴ divide creditors into classes,⁸⁵ propose a viable post-bankruptcy business organization,⁸⁶ and endeavor to achieve consensus among creditors to support the plan.⁸⁷ Through this process, the debtor attempts to propose a plan that will satisfy the creditors while providing the emerging business with an opportunity for a healthy start.⁸⁸

One path through which a plan may be confirmed is by having a majority—defined as greater than half in number and two thirds in value of all classes—approve it.⁸⁹ The debtor is required to submit extensive

79. See 11 U.S.C. § 1129 (2006).

80. *Id.* § 1129(a)(11) (“Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.”).

81. *Id.* § 1121(b) (“Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter.”).

82. *Id.* § 1121(d)(1) (“[O]n request of a party in interest made within the respective periods specified in subsections (b) and (c) of this section and after notice and a hearing, the court may for cause reduce or increase the 120-day period or the 180-day period referred to in this section.”).

83. See *id.* § 1129(a)(11) (requiring the reorganization to be viable, which in turn requires that a reorganizing business in need of capital secure financing in order to have the plan confirmed).

84. See *supra* note 80 and accompanying text. A debtor may thus propose a sale of the business entity as part of the reorganization, eliminating the need for further financing. See *supra* note 80 and accompanying text.

85. 11 U.S.C. § 1122 (2006).

86. *Id.* § 1129(a)(11).

87. *Id.* § 1129(a).

88. *Williams v. U.S. Fidelity & Guaranty Co.*, 236 U.S. 549, 555 (1915).

It is the purpose of the bankrupt act to convert the assets of the bankrupt into cash for distribution among creditors, and then to relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.

Id.

89. 11 U.S.C. § 1126(c) (2006). Classes are defined by the debtor in the plan proposal. See *id.* § 1122. However, creditors may object to these classifications if they are not related to business differences among the creditors. See, e.g., *In re Briscoe Enterprises, Ltd.*, 994 F.2d 1160, 1166–67 (5th Cir. 1991). Differentiation among creditors has been held appropriate based on how the claims were incurred, the ongoing business relationships between the creditors, and the post-

documentation about the business, its valuation, and its prospects to the creditors before a vote is taken on the plan.⁹⁰

If the debtor is unable to achieve a consensual plan, it may force a “cramdown” plan confirmation.⁹¹ A cramdown must meet all the requirements of a consensual plan—absent the agreement of all classes—and at least one impaired class must consent to the plan.⁹² Further, the plan must be “fair and equitable”⁹³ and abide by the “absolute priority rule.”⁹⁴ The “fair and equitable” and “absolute priority rule” standards require that the plan pay secured creditors for the full value of their collateral and market interest before unsecured creditors receive any value.⁹⁵ Unsecured creditors, generally, must also be paid in full before equity holders receive anything.⁹⁶ These requirements assure that equity holders will receive no value unless the higher priority credit classes are paid in full.⁹⁷

confirmation relationships between the creditors. *See, e.g., id.* at 1167 (concluding that separation of unsecured claims is permitted for a “good business reason”).

90. *See* 11 U.S.C. § 1125 (2006); *see also In re Malek*, 35 B.R. 443 (Bankr. E.D. Mich. 1983) (outlining the requirements of adequate disclosure as part of a plan confirmation including “financial information,” “liquidation analysis,” and “transactions with insiders”).

91. *See, e.g., In re Briscoe*, 994 F.2d at 1168–70 (describing a “cramdown” as a plan confirmation under 11 U.S.C. § 1129(b) where a plan is ordered despite a lack of approval by all impaired classes).

92. 11 U.S.C. § 1129(a)(10) (2006) (“If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.”).

93. *Id.* § 1129(b)(1).

[T]he court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

Id.

94. *Id.* § 1129(b)(2)(A)–(C).

95. *See id.*

96. *Id.* § 1129(b)(2)(B).

97. *See* Peter C.L. Roth, Comment, *Bankruptcy Law—The Absolute Priority Rule Reasserted—No Equity Participation Without Tangible Capital Contribution*, 23 SUFFOLK U. L. REV. 857, 861 (1989) (citing *Northern Pac. R.R., v. Boyd*, 228 U.S. 482, 501–04 (1913) (“One of the original purposes of the [absolute priority] rule was to prevent senior secured creditors from entering into collusive arrangements with friendly management to squeeze out the unsecured debt.”)). However, there remains a way for “old equity” to become “new equity”: an old equity holder may give an infusion of new capital and receive a payout less than or equal to that value in equity in the reorganized business. *See Bank of America Nat’l Trust and Sav. Ass’n v. 203 N. LaSalle St. P’ship*, 526 U.S. 434, 453–54 (1999) (“A truly full value transaction, on the other hand, would pose no threat to the bankruptcy estate not posed by any reorganization, provided of course that the contribution be in cash or be realizable money’s worth . . .”). However, strong limitations have been placed on this “new equity” exception including that the new ownership cannot be “on account of” the antecedent debt. *See id.* at 451–53. Also, new capital, and not a promise to work, must be infused into the business. *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203–05 (1988) (holding that debtor farmer’s promise to work on farm and provide “labor, experience, and expertise” in exchange for equity in reorganized entity was inappropriate).

Regardless of whether a plan's confirmation is consensual or a cramdown, any non-consenting creditor may object that the plan is either not in her best interest⁹⁸ or is unfeasible.⁹⁹ For a plan to be in her "best interest," the creditor must receive at least as much as she would have in a Chapter 7 liquidation.¹⁰⁰ For example, if a fully secured creditor objects, she must receive the full value of her claim with market interest rates applied. Second, for a plan to be feasible, its proponent must show that the business will remain viable and will not be liquidated shortly after confirmation—unless that is part of the plan.¹⁰¹ The proponent must show this with reasonable likelihood, though it need not be a certainty;¹⁰² however, inadequate capitalization, and lack of a viable business plan are grounds upon which a plan may be rejected as unfeasible.¹⁰³

These elements demonstrate that the plan confirmation process gives a much greater level of participation and protection to creditors than does a § 363(b) sale.¹⁰⁴ Even though both processes will likely involve negotiations between the debtor and creditors—and a resolution may be achieved over the objections of certain creditors—the plan confirmation process provides many avenues for a creditor to object and encourages consensus among parties.¹⁰⁵ Although having a plan confirmation does not ensure absolutely against abuse or self-dealing, the definitive nature of the "absolute priority rule" and the extensive required disclosures are likely to reduce the possibility of insiders or equity holders receiving a payout at the expense of creditors.¹⁰⁶

However, there are certain indelible drawbacks of a plan confirmation. First, the debtor will likely require exit financing in order for the business to be viable post-bankruptcy—a problem that may be especially acute in markets, such as the current one, in which credit is tight.¹⁰⁷ The plan

98. 11 U.S.C. § 1129(a)(7) (2006).

99. See *id.* § 1129(a)(11). Feasibility may be raised by any non-consenting creditor or the court may analyze it *sua sponte*. See *In re Malkus, Inc.*, No. 03-07711-GLP, 2004 WL 3202212, at *4 (Bankr. M.D. Fla. Nov. 15, 2004).

100. 11 U.S.C. § 1129(a)(7) (2006).

101. *Id.* § 1129(a)(11); see *In re Malkus*, 2004 WL 3202212, at *4.

102. See *Malkus*, 2004 WL 3202212, at *4 ("Pursuant to § 1129(a)(11) a plan of reorganization must be feasible. 'Although success does not have to be guaranteed, the Court is obligated to scrutinize a plan carefully to determine whether it offers a reasonable prospect of success and is workable.'") (quoting *In re Yates Development*, 258 B.R. 36, 44 (Bankr. M.D. Fla. 2000)).

103. See, e.g., *id.*

104. See Rose, *supra* note 22, at 256–58 (discussing the voting, classification and good faith requirements as hallmarks of the Bankruptcy Code's protection of creditors).

105. See discussion *supra* Part II.A.

106. See Sloane, *supra* note 22, at 39–45.

107. See Melvin Richardson, *How Does a Tight Credit Market Affect the Economy?*, ASSOCIATED CONTENT FROM YAHOO (Oct. 30, 2008), http://www.associatedcontent.com/article/1138008/how_does_a_tight_credit_market_affect.html.

confirmation period may take an inconveniently long time.¹⁰⁸ During this period, the debtor's business, being tied up in court proceedings,¹⁰⁹ may suffer significant reputational damage.¹¹⁰ This reputational damage, coupled with the debtor's inability to obtain financing and the costs of running the bankruptcy itself—including legal fees—may strain the business to the point of collapse, causing the case to be converted to Chapter 7¹¹¹ and the creditors to lose the “going concern value” that Chapter 11 is intended to preserve.¹¹²

B. SCHOLARLY DEBATE OVER § 363(b) SALES: PANACEA FOR LARGE BUSINESS REORGANIZATIONS OR AN ALTERNATIVE VULNERABLE TO ABUSE?

Many academics have supported the use of § 363(b) sales.¹¹³ One argument is that they insulate the sales of going concern businesses, whereby sums of money are guaranteed and parties will determine distributions after the sale from long confirmation processes.¹¹⁴ In a plan reorganization, the business entity is kept within the bankruptcy estate for a substantial period of time, where it incurs significant legal and administrative costs, must secure operating capital, and suffers reputational damage.¹¹⁵ In a § 363(b) sale, the debtor need not obtain DIP financing,¹¹⁶

108. See generally Miller & Waisman, *supra* note 21. Bankruptcy cases may take years to complete whereas a § 363(b) sale may be consummated in a few months, or even significantly less. See generally *id.*

109. *Id.* at 187–89 (arguing that bankruptcy proceedings may evolve into a confrontation of wills, where a creditor may prolong the process in hopes of forcing a concession).

110. Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a “Race to the Bottom”*, 54 VAND. L. REV. 231, 235–36 (2001) (describing reputation damage along with other distractions that companies suffer from bankruptcies, which leads to reorganized public companies filing repeatedly for bankruptcy protection).

111. 11 U.S.C. § 1112 (2006) (listing the requirements that allow a party of interest, “after notice and a hearing,” to petition the court for conversion of the case to a chapter 7 liquidation).

112. See *In re 15375 Memorial Corp.*, 400 B.R. 420, 427 (D. Del. 2009) (“preserving a going concern” or “maximizing the value of the debtor’s estate” are goals of filing for bankruptcy protection) (citation omitted).

113. See, e.g., Lee, *supra* note 21; Miller & Waisman, *supra* note 21; Paul N. Silverstein & Harold Jones, *The Evolving Role of Bankruptcy Judges Under the Bankruptcy Code*, 51 BROOK. L. REV. 555 (1985).

114. See generally Miller & Waisman, *supra* note 21 (discussing the many obstacles that have entered the reorganization plan confirmation process, including strategic objections, employee and key vendor benefits and greater costs).

115. See generally *id.* Greater sophistication by creditors and an increasingly service based economy has turned the Chapter 11 landscape into a more contentious process that may no longer yield the “going concern” premium that formerly existed in the railroad bankruptcies. See *id.* at 182 (“[D]istressed debt traders’ entry into the reorganization paradigm has transformed Chapter 11 reorganizations from primarily rehabilitative processes to dual-purpose processes that stress maximum enhancement of creditor recovery in addition to rehabilitation of the debtor entity.”).

116. See generally David A. Skeel, Jr., *The Past, Present and Future of Debtor-In-Possession Financing*, 25 CARDOZO L. REV. 1905 (2004) (describing the history and current use of “DIP

which may be unavailable or only available at a substantial rate.¹¹⁷ The sale, it is argued, provides a level of certainty that a plan confirmation cannot: it ensures that a level of assets that will be split among creditors and obviates the need for a time-consuming and expensive valuation finding during plan confirmation.¹¹⁸ Creditors also need not focus on the workings of the business or fear that the business will leak losses, implode, and require liquidation.¹¹⁹ The sale of the assets, if performed correctly, would also likely yield a more reliable price than expert valuations presented to a bankruptcy judge,¹²⁰ a result in line with the Code's policy of preferring market valuation when possible.¹²¹

financing"). DIP financing refers to financing made available to a debtor during the course of its bankruptcy proceedings in order to finance the ongoing restructuring as well as a viable reorganization. *See generally id.*; *see also* 11 U.S.C. § 364 (2006) (providing courts with power to approve financing for the debtor in possession).

117. *See Lee, supra* note 21, at 546. A quick sale of assets may be necessary where a business runs out of cash collateral financing and DIP financing is unavailable. *See id.*

118. *See* George W. Kuney, *Let's Make It Official: Adding an Explicit Preplan Sale Process as an Alternative Exit From Bankruptcy*, 40 HOUS. L. REV. 1265, 1270 (2004) ("[T]he insolvency community has embraced the nonplan sale of substantially all the assets of a debtor's business as an efficient alternative to the costly and lengthy plan confirmation process.") (internal citations omitted). 363(b) sales secure a price for a firm's assets and allow creditors to focus on achieving a plan to distribute assets. *See id.*

Further, by reducing the assets of the estate to cash, a note secured by the assets sold, the stock of the purchaser, or some other similar form of fungible valuable consideration, the tasks and costs of postsale management and administration of a debtor and its estate can be dramatically reduced.

Id. at 1270–71 (internal citations omitted). This will reduce monitoring cost as the creditors no longer must analyze market conditions or the managerial decisions of the debtor. *See id.*

In turn, this allows for a reduction in the amount of a debtor's value that is redistributed from prepetition creditors to postpetition administrative claimants as a case drags on. It takes little in the way of a management team to preside over an estate comprised solely of liquid assets.

Id. at 1271 (internal citations omitted).

119. *See* 11 U.S.C. § 1112 (2006) (requiring that a company that is unable to emerge from chapter 11 as a viable entity will either be converted to chapter 7 liquidation or the bankruptcy case will be dismissed).

120. *See* Barry E. Adler & Ian Ayres, *A Dilution Mechanism for Valuing Corporations in Bankruptcy*, 111 YALE L.J. 83, 90 (2001) ("Not only do judges lack the business expertise of individual capital investors, but also a judicial valuation cannot benefit from the collective wisdom of market investors in the aggregate. As a result, even unbiased judges make mistakes that a market process would not permit."). An open and populated market should yield efficient outcomes, demonstrating the true value of the asset. *See Oversight of TARP Assistance to the Automobile Industry: Field Hearing Before the Congressional Oversight Panel*, 111th Cong. 97–108 (2009) (statement of Barry E. Adler, Professor of Law, New York University School of Law) (advocating putting all large § 363(b) sales through a stringent market test to ensure fair price and prevent abuses) [hereinafter *Automotive Field Hearings Memorandum*].

121. *See In re Iridium Operating LLC*, 373 B.R. 283, 293 (Bankr. S.D.N.Y. 2007) ("[T]he public trading market constitutes an impartial gauge of investor confidence and remains the best and most unbiased measure of fair market value and, when available to the Court, is the preferred standard of valuation.") (citing *VFB LLC v. Campbell Soup Co.*, 482 F.3d 624 (3d Cir. 2007)).

Looking at these benefits—including shorter time in bankruptcy, certainty, fewer resources used—as a whole, it may be difficult to dispute the use of these sales procedures. In fact, some academics believe that the § 363(b) sale is the future of bankruptcy and that few if any large bankruptcies benefit from a drawn out confirmation plan.¹²² Others, while not ruling out the usefulness of the plan confirmation process, contend that the process is no longer viable for large distressed businesses and that, absent major revisions to the Code, the § 363(b) sale may be, in certain circumstances, a useful and prudent solution.¹²³

While there is major support for the use of § 363(b) sales, there are critics who argue that the procedure is fraught with possibilities for abuse and enables parties to effectuate sweetheart deals.¹²⁴ These critics argue that the use of § 363(b) sales increases the ability of insiders to engage in self-dealing, given the lighter scrutiny to which the sales are subjected.¹²⁵ They argue further that benefits to insiders such as continued employment, assignment of liability, and even payment may be provided by the purchaser in exchange for the debtor supporting and obtaining approval of the sale, and that this may be particularly true in § 363(b) sales in which a parent company or former equity holders acquire the business.¹²⁶

Imperfections in valuation and the auction procedures used by various bankruptcy courts may allow a creditor or third party to purchase a business at well below value.¹²⁷ Commentators argue that because insiders do not usually gain in the distribution of assets, it may be worthwhile for them to sell to a third party at below market value while receiving an outside benefit, such as those described in the previous paragraph.¹²⁸ Further, if the debtor has special knowledge about the business and is in the best position to value the company, she may also be in the best position to argue for a low valuation and provide the benefit to a purchaser at the cost of creditors.¹²⁹ Commentators have responded differently to this problem of valuation. Some have responded by arguing for a market test, whereby market forces will dictate the fair price for the asset and prevent abuses that stem from undervaluation.¹³⁰ Other commentators argue that a market test

122. See, e.g., Lee, *supra* note 21, at 562.

123. See Miller & Waisman, *supra* note 21, at 199–200.

124. See generally Rose, *supra* note 22.

125. See *id.* at 277–80 (arguing that the debtor in possession may have conflicts of interest that encourage selling to insiders or affiliated companies and may yield deals that provide a windfall for third parties at the expense of creditors).

126. See *id.*

127. See *id.* at 277–78 (discussing how manipulation of valuations and auction procedures can lead to depressed pricing).

128. See LoPucki & Doherty, *supra* note 22, at 30–31.

129. See Rose, *supra* note 22, at 277–78 (describing how insiders profited when Polaroid was sold for \$465 million despite \$1.8 billion in assets).

130. See *Automotive Field Hearings Memorandum*, *supra* note 120 (discussing how open auctions will reveal when parties are receiving unduly favorable terms).

cannot cure the abuses and inappropriate outcomes that flow from the speed and absence of disclosure in § 363(b) sales.¹³¹

There also exists the possibility that a § 363(b) sale will be used to effectuate a *sub rosa* plan in which the purchaser can gain significant returns at the expense of other creditors.¹³² As part of a sale, ownership of the traded asset may be distributed; in *General Motors*, for example, both the employee pension fund and the union received significant portions of the new company without a commensurate contribution of capital.¹³³ Although such transactions meet the technical definition of a *sub rosa* plan, they are not always labeled as such, effectively allowing the debtor to distribute assets without complying with the plan confirmation requirements of § 1129 of the Code.¹³⁴ Commentators have been especially wary of these kinds of sales, as creditors will not only lose in their payout but are also locked out of the process.¹³⁵

Those opposing the current proliferation of § 363(b) sales do not necessarily contest its use in all circumstances or deny its appeal; instead, they argue for increased procedural safeguards or limitations.¹³⁶ They claim that these procedures should be subject to a more stringent inquiry into whether the plan does, in fact, constitute a *sub rosa* plan bypassing the safeguards of a plan confirmation process.¹³⁷ Additionally, some commentators argue for a market test for § 363(b) sales so as to ensure that insiders are not effecting “sweetheart deals,”¹³⁸ whereas others argue for a heightened “business justification” standard.¹³⁹ These concerns highlight the procedural disadvantages of § 363(b) sales despite acknowledging the great benefits that may accrue from their use. From this, it becomes clear that availability of § 363(b) sales procedures should be preserved—and possibly encouraged—but that precautions must be taken to prevent the types of abuses to which they are currently susceptible.

III. PROPOSED SOLUTION

This note has focused on two areas of abuse that exist in § 363(b) sales: 1) the ability of insiders or other parties to purchase the company at below

131. See, e.g., LoPucki & Doherty, *supra* note 22, at 40–45.

132. See Sloane, *supra* note 22, at 60–63.

133. *In re General Motors Corp.*, 407 B.R. 463, 482–83 (Bankr. S.D.N.Y. 2009).

134. See Sloane, *supra* note 22, at 51 (discussing how decisions applying *Braniff* have generally allowed § 363(b) sales to go through, which alleviates the debtor’s need to make disclosure or gather consenting creditor votes).

135. See *id.* at 62.

136. See, e.g., *Automotive Field Hearings Memorandum*, *supra* note 120, at 106–08; LoPucki & Doherty, *supra* note 22, at 44–45; Rose, *supra* note 22, at 283–84.

137. See Sloane, *supra* note 22, at 62.

138. See *Automotive Field Hearings*, *supra* note 120 (advocating for a *true* market test to ensure that sale value is maximized and that the sale does not deprive creditors’ of the safeguards that the Bankruptcy Code provides them).

139. See Rose, *supra* note 22, at 283–84.

market value; and 2) the ability of the debtor or insiders to compel a sale in order to secure a benefit for themselves at the expense of creditors. These abuses can be significantly reduced by employing a robust market test that includes disclosure of all terms of the sale, adequate time for bidders to respond, and a centralized forum to receive—and notify all affected parties of—purchase bids.¹⁴⁰

Additionally, where a quick sale is required and a meaningful market test cannot be implemented, the standard for justifying the sale should be heightened.¹⁴¹ These changes will provide fairness and credibility, and will limit uses of § 363(b) sales to subvert the Code's protection of creditors.¹⁴²

A. A ROBUST MARKET TEST

Academics and practitioners have proposed that § 363(b) sales should require a market test to ensure that the price paid for assets in the sale is fair, and to provide interested bidders with a forum to purchase the property.¹⁴³ Proponents of a market test argue that it provides safeguards necessary to ensure fairness and prevent abuse.¹⁴⁴ First—assuming the existence of an efficient and populated market—arbitrageurs, speculators, and other participants should theoretically raise the company's value to its “market price.”¹⁴⁵ This would prevent insiders from colluding with a purchaser to sell the company at an artificially low price in exchange for side benefit.¹⁴⁶ Similarly, the market test may attract purchasers who can significantly raise the returns of the company, possibly through synergies or economies of scale.¹⁴⁷ If details of the sale are made public and scrutinized,

140. See generally Adler, *supra* note 14, at 317–18 (proposing the “sort of process that state law would provide shareholders of a solvent firm”).

141. See Rose, *supra* note 22, at 283 (“The complexities of a § 363 sale require intensified scrutiny because of the dangers of debtor manipulation of market forces.”).

142. See discussion *supra* Part II.A (detailing the protections afforded to creditors in a bankruptcy plan reorganization).

143. See generally Rachael M. Jackson, Note, *Responding to Threats of Bankruptcy Abuse in a Post-Enron World: Trusting the Bankruptcy Judge as the Guardian of Debtor Estates*, 2005 COLUM. BUS. L. REV. 451; see also, Rose, *supra* note 22.

144. See Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 786–88 (2002); Lee, *supra* note 21, at 536–37.

145. See Daniel R. Fischel, *Market Evidence in Corporate Law*, 69 U. CHI. L. REV. 941, 942 (2002) (“The fair market value of an asset is generally defined as the price at which the asset would change hands in a transaction between a willing buyer and a willing seller when neither is under any compulsion to buy or sell and both are reasonably informed.”).

146. See *id.* at 947 (acknowledging that a price below fair value will attract other purchasers).

147. See Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 598, 608 (1989).

An important source of potential gain from takeovers is synergy between buyer and seller that permits the merged company to be run more efficiently. Three sources of synergy can be distinguished: (i) operating synergy resulting from economies of scale or scope; (ii) improved management of the target; and (iii) financial or managerial synergy due to more efficient use of capital or management talent.

proponents of the sale will, in theory, be deterred from engaging in fraud or side deals. Thus, the market test may also provide a level of certainty and fairness simply from its procedure.¹⁴⁸

This model of market arbitrage and an effective market test may be criticized as simple and overly optimistic as it assumes a populated market, low transaction costs, and complete information.¹⁴⁹ Although such conditions, or even conditions approaching these, are unlikely, bankruptcy courts may foster a more favorable environment for bidders to produce a populated auction and thereby increase possible revenue.¹⁵⁰ To emulate such optimal market conditions, a *robust* effective market test should require: 1) full disclosure of proposed bids; 2) adequate time to respond to the bids by all parties and purchasers; and 3) creditor and judicial review of competing bids.

1. FULL DISCLOSURE OF SALE TERMS

A debtor loses many privacy protections that it had outside of bankruptcy, including required post-petition disclosure when proposing the confirmation plan.¹⁵¹ Also, a debtor is required to accept better bids, if offered, in a § 363(b) sale.¹⁵² However, these alone may be insufficient to ensure an effective market test.

Under the current regime, the complete details of a sale are not always provided, made public, or even available.¹⁵³ While requiring a purchasing company to reveal all elements of its purchase and act as a “stalking horse” may be harsh, the protections that the bankruptcy sale will provide them—including the ability to purchase “free and clear” of encumbrances¹⁵⁴ and the limited appealability of § 363(b) sales¹⁵⁵—should make for a fair

Id.

148. See Rose, *supra* note 22, at 277–83.

149. See Fischel, *supra* note 145, at 944–47 (discussing unrealistic assumptions underlying analysis of fair market price).

150. See generally Steven B. Katz, Note, *Designing and Executing a “Fair” Revlon Auction*, 17 FORDHAM URB. L.J. 163, 183 (1989) (“[I]ncreasing the number of bidders in an auction increases the probability of a particular bidder having the highest valuation, thereby usually raising the seller’s revenue.”).

151. See 11 U.S.C. § 1125 (2006).

152. See *In re Gulf States Steel, Inc. of Ala.*, 285 B.R. 497, 517 (Bankr. N.D. Ala. 2002) (citing *In re Lionel*, 722 F.2d 1063 (2d Cir. 1983)) (“In a liquidation case it is ‘legally essential’ to approve the highest offer”); see generally *Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (requiring the Board of Directors, in a sale of control context, to maximize shareholder’s equity).

153. See Rose, *supra* note 22, at 260 (“With a § 363 sale, fewer people receive less information, and the lack of a disclosure requirement weakens creditor leverage”).

154. 11 U.S.C. § 363(f) (2006).

155. *Id.* § 363(m).

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

tradeoff. By making details of the transaction and proposals public, potential purchasers will be able to assess the fairness of current proposals, and may outbid current offers that undervalue the company, in an attempt to receive a profit.¹⁵⁶

Additionally, companies do not necessarily submit bids that only differ in price or in a limited number of provisions; quite the opposite, bids for distressed companies often vary widely.¹⁵⁷ One purchaser may provide a higher price but will dismantle the company for its assets and consumer base,¹⁵⁸ while another plan may infuse capital and expertise into expanding the business but at a lower price.¹⁵⁹ Depending on the particular circumstances of the distressed business, either plan may prove to be a better solution for the creditors and for the public at large.

Only by making full disclosure of the bids submitted can interested and official parties effectively evaluate which of multiple proposals to accept.¹⁶⁰ Increasing the availability of information will serve two purposes for potential purchasers. First, it will lower transaction costs to bidders, enabling them to base their offers on a better evaluation of the company.¹⁶¹ Second, because an offer will serve as an indicator of the selling company's value,¹⁶² hesitant market participants may be reassured of the soundness of an investment in the company, thus increasing the likelihood of a competitive auction.¹⁶³

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.

Id.

156. See generally Katz, *supra* note 150, at 184–85 (describing “Revlon” type auctions where “[b]y increasing his bid, the bidder decreases his potential profit, but increases his probability of winning. . . . [which forces the bidder to] close the gap between his bid and his honest valuation”).

157. Compare *In re Chrysler LLC (Chrysler I)*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009) (approving a sale of a business for ownership and infusion of capital and expertise in a transaction between Fiat and Chrysler); with *In re Enron Corp.*, 291 B.R. 39, 40 (S.D.N.Y. 2003) (approving a straight sale of a business entity for cash or its equivalent).

158. See, e.g., *Enron*, 291 B.R. at 40 (approving the sale of Enron Wind Corp., a subsidiary of Enron Corp., to General Electric Co. for a combination of cash and assumption of liabilities).

159. See, e.g., *Chrysler I*, 405 B.R. at 96 (approving the sale following consideration the synergies that Fiat could provide Chrysler, including new technologies and an international network, in ordering the § 363(b) sale).

160. Theodore N. Mirvis & Andrew J. Nussbaum, *Mergers and Acquisitions and Takeover Preparedness*, 907 PLI/CORP. HANDBOOK SERIES 501, 536–37(1995) (the board of directors in a change of control context must analyze all factors of a bid including price, feasibility and identity of the bidder in calculating the “best value” for its shareholders).

161. See generally David E. Van Zandt, *The Market as a Property Institution: Rules for the Trading of Financial Assets*, 32 B.C. L. REV. 967, 985–86 (1991).

162. See generally *id.*

163. See Katz, *supra* note 150, at 187–88 (“[An] advantage of the seller publicizing information is that the cost of preparing a bid is lowered. Lower bid preparation costs may entice additional bidders to enter the auction, thereby creating a more competitive auction and increasing the seller's expected return.”).

Full disclosure would also reveal and deter fraud or insider dealing as it does in federal securities law.¹⁶⁴ There are three categories of entities that have an incentive to find self-dealing, fraud, or other problems in the plan. Official entities, such as the court or a United States trustee, will be attentive to these problems as part of their official duty.¹⁶⁵ Second, creditors that stand to be impaired by the sale have the incentive to scrutinize and oppose it for such imperfections.¹⁶⁶ Finally, competing purchasers are also in a position to analyze the plan for faults and may profit by outbidding for what they deem to be an undervalued asset.¹⁶⁷ Full disclosure will provide all of these parties the means to analyze bids and ferret out abuse.

Requiring the parties proposing a § 363(b) sale to make full disclosure should encourage market participants to bid on the asset in question.¹⁶⁸ Competitive bids such as these are more likely to result in a fair market valuation of the sale asset.¹⁶⁹ Ultimately, disclosure is beneficial because it disincentivizes the proposing parties from engaging in fraud, self-dealing, or other abuses that they would not want exposed to the public.

2. ADEQUATE TIME FOR MARKET PLAYERS TO RESPOND TO THE SALE.

In addition to requiring disclosure of the details of the § 363(b) sales, the court should provide sufficient time to market players to respond to the test and bid on the company. In order for a market test to reveal whether a price is fair or if other purchasers can provide better terms, there needs to be a sufficient opportunity for bidders to research, plan, and draft competing proposals.¹⁷⁰ Potential purchasers must be provided with enough time to formulate bids and be assured that their bids will be given proper

164. See generally Richard E. Mendales, *Looking Under the Rock: Disclosure of Bankruptcy Issues Under the Securities Laws*, 57 OHIO ST. L.J. 731, 738–39 (1996) (explaining how disclosure in securities law serves a regulatory purpose allowing interested private parties to monitor themselves).

165. U.S. Trustee Program, Strategic Plan & Mission, U.S. DEP'T OF JUSTICE, http://www.justice.gov/ust/eo/ust_org/mission.htm (“The USTP’s mission is to promote integrity and efficiency in the nation’s bankruptcy system by enforcing bankruptcy laws, providing oversight of private trustees, and maintaining operational excellence.”).

166. See Barry L. Zaretsky, *Fraudulent Transfer Law as the Arbiter of Unreasonable Risk*, 46 S.C. L. REV. 1165, 1172–73 (1995) (arguing that “impaired debtors who receive less than reasonably equivalent value may unfairly or improperly harm creditors even when the debtor did not have intention to cause harm to its creditors[,]” thereby incentivizing creditors to scrutinize debtor activities).

167. See generally Katz, *supra* note 150, at 181–88.

168. See *id.* at 187.

169. See *id.*

170. See LoPucki & Doherty, *supra* note 22, at 25–26, 41–42 (finding that there were significant costs, in the range of \$5 million, in formulating a bid in a § 363(b) sale and recovery rates in such sales increased with the length of the market test).

attention.¹⁷¹ A sale that does not provide sufficient time for market players to respond to proposals will be ineffective and merely pro forma.¹⁷²

To ensure that adequate notice for market participation exists, the court can publish the terms of the sale and an invitation for competing bids. This type of publication should be tailored to the target audience and costs can vary with the value of the asset being sold.¹⁷³ Thus, while taking out a newspaper ad for a large corporation—such as General Motors or Chrysler—is worthwhile, it would be unreasonable to require it for a small asset, as the cost of publication would significantly reduce payouts to creditors.¹⁷⁴

This notice should provide a timeline in which offers will be accepted and evaluated.¹⁷⁵ The period must be clear as the parties that will expend resources on preparing and submitting a bid will need assurance that their bids will be adequately reviewed and considered against the current sale agreement.¹⁷⁶

It is reasonable for investors to be wary of participating in a market test. The drafters of the sale may argue that losing their initial agreement may cause uncertainty, and that subsequent bids may change terms that have already been considered and accepted.¹⁷⁷ However, for the market test to be effective, new bids must be evaluated on equal footing with the proposed agreement.¹⁷⁸ A period in which all proposals are considered—along with the requirement that bids be considered by both the court and impaired creditors¹⁷⁹—is a proper solution to this problem because it ensures that if a new and better offer is proposed with a reasonable time frame, it may replace the agreed upon sale.

171. *See id.* at 26 (finding that although “the recovery ratio for a reorganized company decreases with time in bankruptcy[,] . . . the recovery ratio of a sold company increases with time in bankruptcy”).

172. Publication and adequate time to formulate a bid are factors that should foster greater bidder participation in order to maximize price. *See generally* Katz, *supra* note 150, at 183, 187.

173. *See Automotive Field Hearings Memorandum, supra* note 120, at 107 (proposing that auction procedures should not apply to small businesses as they would be unable to recoup the costs).

174. *See id.* (arguing that publication of terms and market tests may not be feasible for smaller assets).

175. *But see id.*

176. Proponents of a § 363(b) sale are however reluctant to entertain competing offers and stifle true bidding through selecting a “stalking horse” and implementing short bidding periods once the “stalking horse” has been selected. *See* LoPucki & Doherty, *supra* note 22, at 35–36.

177. *See* Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 747–51 (2010) (describing the bidding process in Chrysler and how there was a requirement that new bids be approved by multiple committees and conform to standards enacted by the proponent, which demonstrates a sale proponent’s desire to consummate an existing offer so as not to lose its proverbial “bird in the hand”).

178. *See* Katz, *supra* note 150, at 175 (arguing that sellers need to be committed to the auction process for bidders to put forth their best offers).

179. *See* discussion *infra* Part III.A.3.

Finally, the adequate time provision must give investors sufficient time to formulate and propose a competing bid.¹⁸⁰ The amount of time necessary should depend on the size of the asset, current market conditions, liquidity of the asset, and prior shopping for purchasers, among other factors.¹⁸¹ For example, a large asset such as an automotive manufacturer may require that purchasing companies seek outside funding, thus raising the time necessary to form a bid. Similarly, in tight capital conditions, such as those of the current economy, bidders may require more time to secure the capital for the purchase. A court implementing a market test must be cognizant of these factors to ensure that the market test is an effective one.

3. CREDITOR AND JUDICIAL REVIEW OF COMPETING BIDS

A third requirement that will provide for an effective market test is review of competing bids by the court and by impaired creditors. This requirement is important because: 1) it will provide for impartial review of bids that benefit creditors as a class and incentivize the bidding process;¹⁸² 2) it will deter insiders from proposing “sweetheart” or self-interested deals;¹⁸³ and 3) it will create a centralized forum to receive and evaluate bids.

The first benefit of requiring review by parties other than the proponent of the § 363(b) sale¹⁸⁴ is that potential bidders will have more confidence that their bids will be reviewed and that their diligence will not go to waste.¹⁸⁵ As with the adequate time provision, this element facilitates the environment necessary for a competitive bidding process.¹⁸⁶

180. See Warburton, *supra* note 13, at 567.

363 sales proceeded at an unnecessarily fast pace. The bankruptcy courts in each case required that any competing bid be submitted within a matter of days. Critics cite the short amount of time permitted for competing 363 bids as an additional constraint imposed on the bidding process. In other words, the speed of the process purportedly discouraged the submission of competing bids, impeding a true market valuation of the assets.

Id.

181. See *Automotive Field Hearings Memorandum*, *supra* note 120, at 107 (advocating for market test to conform to state law requirements and provide bidders with adequate time to formulate their bids).

182. See Katz, *supra* note 150, at 178 (describing how bidders will be disincentivized from participating in an auction if there is a significant risk that their bid will fail).

183. See Rose, *supra* note 22, at 272–83.

184. This could include either the creditors, perhaps through a committee of unsecured creditors, or by the court.

185. See generally Robert U. Sattin, *Finality in Auction Sales: It Ain't Over Till It's Over*, 23 AM. BANKR. INST. J., 52, 53 (2004) (describing the finality of auctions as a necessary element that ensures that bidders are confident that their bids will receive due consideration and will not be upset by subsequent events); see also generally Katz, *supra* note 150.

186. See generally Katz, *supra* note 150 (creating an auction that entices bidders will draw more bidders and in turn increase the probability of obtaining a higher bid price).

The second benefit of third party review of competing bids is that it should deter proponents from proposing plans with an unfairly low price or that retain benefits to themselves.¹⁸⁷ If a party realizes that its attempt at deceiving the system will likely be caught, it is less likely to engage in the devious conduct.¹⁸⁸

The test will also provide a centralized forum for the receipt of bids, affording some measure of assurance and cost savings to bidding parties.¹⁸⁹ Although not as significant as the other elements described, requiring creditors and the court to consider all bids will provide an auction atmosphere in which parties may compete with each other in the open. This will ensure that the debtor cannot unfairly discriminate among purchasers and will also lower the transaction costs for bidding parties of obtaining information.¹⁹⁰ Finally, and optimistically, such a centralized forum may facilitate a bidding war that will increase the purchase price to the benefit of all creditors.¹⁹¹

The elements of the robust market test are designed to mimic a competitive market and provide the protections similar to those of a reorganization plan confirmation. They are also meant to ensure a proper review of the sale, and to give outsiders and creditors leverage over a self-interested sale proponent as well as provide them with more satisfaction from the process.

4. A **ROBUST** MARKET TEST CAN BE EFFECTIVE

Some current commentary contends that market sales are either ineffective, difficult to implement, cost prohibitive, or some combination of all three.¹⁹² While it is not argued that the steps outlined above will provide an optimal solution, this note's proposal takes these arguments into account.

It is conceded that a market test may not be possible under all circumstances, nor is it feasible that all market tests should be equally

187. See generally LoPucki & Doherty, *supra* note 22 (discussing the side dealings and abuses that occur in an undervalued § 363(b) sale); see also Rose, *supra* note 22.

188. See generally Gary S. Becker, *Crime and Punishment: an Economic Approach*, 76 J. POL. ECON. 169, 176–78 (1968) (outlining the deterrence effect and arguing that criminals take costs of their actions into account when committing crimes, that costs are measured by the sanction for the act, and are multiplied by the chance of being caught). Under the deterrence theory, raising either the sanction or the probability of being caught makes the action less valuable and hence deters a potential actor from engaging in the act. *Id.*

189. See LoPucki & Doherty, *supra* note 22, at 5 (“[T]he high costs of evaluating companies, combined with the low probability of success for competing bidders, discourages competitive bids.”).

190. See Katz, *supra* note 150, at 187–88.

191. See *id.* at 183.

192. See, e.g., LoPucki & Doherty, *supra* note 22, at 41–45 (reporting results from a study of recent § 363(b) sales that yielded results that found that sales undervalue the company as compared to a plan reorganization and failed to bring in competing bids).

stringent.¹⁹³ The type and duration of the market test, the form of marketing devices to be used, and the choice between a formal bidding process and an auction, should all be determined on a case-by-case basis.¹⁹⁴

Criticisms that a market test would prove ineffective are based on faults with the procedures currently in use, not with the market test concept itself.¹⁹⁵ It has been argued that market tests fail to bring in bidders and do little to no good in raising § 363(b) sale prices or deterring abuse.¹⁹⁶ However, the three elements of the proposed *robust* market test would alleviate such problems. First, requiring greater disclosure would give potential bidders greater access to the information they need to formulate a bid that they believe will be successful.¹⁹⁷ Second, an adequate period of time would allow more players to enter the bidding process and provide them with more incentive to prepare and submit bids.¹⁹⁸ Third, an impartial weighing of bids would provide outside bidders a greater opportunity to present their case and have their bids considered.¹⁹⁹ While this may not entirely eliminate the problems of the current § 363(b) market test, they will make the market tests more effective and provide greater certainty as to adequacy of price while deterring abuse.

B. HEIGHTENED SCRUTINY OF THE “TIME IS OF THE ESSENCE” SALE

One important and controversial justification for the use of § 363(b) sales and their quick implementation is the “time is of the essence” rationale.²⁰⁰ This justification relies on an extrinsic factor—usually a back-out date in a sale agreement—to require the quick ordering of a sale before the purchaser pulls out and/or the business implodes.²⁰¹ Both the *Chrysler* and *General Motors* cases employed this justification for their expedited

193. See *Automotive Field Hearings Memorandum*, *supra* note 120, at 107.

194. See *id.* A market test must be tailored to the asset being sold as well as the prospective market. See *id.* Particularly, the cost of the auction must not be so large in comparison with projected proceeds as to make the auction unreasonable. See *id.*

195. See, e.g., LoPucki & Doherty, *supra* note 22, at 41 (debtors often offer bid incentives to the stalking horse making subsequent offers harder to obtain); Rose, *supra* note 22, at 282 (“The market cannot correct deal protection fees, credit bidding, and disparity in bidders’ information. Additionally, the debtor’s ability to limit participants even with open auctions makes the courts’ use of market exposure as an objective standard insufficient as well.”).

196. LoPucki & Doherty, *supra* note 22, at 41–42.

197. See discussion *supra* Part III.A.1.

198. See discussion *supra* Part III.A.2.

199. See discussion *supra* Part III.A.3.

200. See, e.g., *In re Thomson McKinnon Sec., Inc.*, 120 B.R. 301, 307 (Bankr. S.D.N.Y. 1990).

201. See, e.g., *In re General Motors Corp.*, 407 B.R. 463, 480 (Bankr. S.D.N.Y. 2009); *In re Titusville Country Club*, 128 B.R. 396, 397 (Bankr. W.D. Pa. 1991); *Equity Funding Corp. of Am. v. Financial Assocs.*, 492 F.2d 793, 793 (9th Cir. 1974).

sales²⁰² and it has been established as a valid justification in a variety of circumstances.²⁰³

“Time is of the essence” has been criticized by certain academics. One argument against the justification is that it is difficult, if not impossible, to determine whether the purchaser will actually back out of the deal²⁰⁴ or if the back-out date is being used to subvert the bankruptcy process and avoid scrutiny.²⁰⁵ Another argument is that it provides perverse incentives to the management of an ailing business to only declare bankruptcy when a “drop dead date” is imminent and the business is unable to withstand a lengthy bankruptcy.²⁰⁶

A solution must deter purchasers from abusing the bankruptcy system while providing the court with the flexibility needed to address novel and drastic situations. Because a quick sale will preclude an effective market test and the safeguards that the test ensures, courts should require the proponents of a “time is of the essence” § 363(b) sale to face heightened scrutiny.²⁰⁷ Those invoking the justification should be required to provide compelling reason for the necessity of the sale and the deadline. The court should also analyze the substance of deals for insider benefit and self-dealing.²⁰⁸ Further, because the market test and this heightened scrutiny are designed to combat abuse, the court may lower the level of scrutiny involved where time for a market test is provided, even though truncated, while heightening scrutiny of sales with imminent sale dates.

202. See *In re Chrysler LLC (Chrysler I)*, 405 B.R. 84, 96–97 (Bankr. S.D.N.Y. 2009) (considering the timeline set out by Fiat for the *Chrysler* merger in ordering the sale); *General Motors*, 407 B.R. at 480 (considering the United State Government’s requirement that the sale be consummated quickly as justification for ordering the sale).

203. See, e.g., *In re Thomson McKinnon*, 120 B.R. at 307.

Time is of the essence because the contracts with the key employees will expire by January 2, 1991, whereas the trustees of the Funds have threatened to terminate their arrangements with the Partnership if a prospective purchaser is not promptly approved who could offer investment management services which would meet with their approval.

Id.; *In re Oneida Lake, Inc.*, 114 B.R. 352, 355–57 (Bankr. N.D.N.Y. 1990) (ordering a sale based on rapidly decreasing market value and an open sale, despite not using “time of the essence” language).

204. See Sloane, *supra* note 22, at 60–61.

205. See *id.* (arguing that expedited sales procedures may be used to disenfranchise creditor voting and “short circuit” bankruptcy safeguards).

206. See *General Motors*, 407 B.R. at 480; see also LoPucki & Doherty, *supra* note 22, at 37 (discussing the probable effect of a drop dead date on the sale price).

207. See Roe & Skeel, *supra* note 177, at 749 (noting that the bidding process in *Chrysler* occurred in a little more than a week, giving bidders insufficient time to perform due diligence or obtain financing, thereby circumventing the protection that the market test is intended to provide).

208. See, e.g., Rose, *supra* note 22, at 280–83 (discussing the ability of the debtor to circumvent an effective market test and to distort valuation requiring “intensified scrutiny”).

1. THE NECESSITY OF THE SALE/DEADLINE ANALYSIS

Courts, following *Lionel*, require the proponent of a § 363(b) sale to provide “good business justification” for implementing the sale.²⁰⁹ In “time is of the essence” cases, the need to effect a sale before the termination date of purchase contract along with a showing that the sale is in the best interests of the creditors has been sustained as sufficiently good justifications for the § 363(b) sale.²¹⁰ This analysis requires that the sale provide at least as much as to creditors as a liquidation of the company’s assets.²¹¹ Further, it must be shown that it is unlikely that a market test would fetch a higher price for the company.²¹² Courts also require that the sale be necessary, either by showing that the company will be unable to secure financing to fund its bankruptcy²¹³ or that the company is wasting away in the bankruptcy process.²¹⁴

When a “time is of the essence” justification is used, courts may lower the scrutiny given to the factors provided in *Lionel*.²¹⁵ The need to implement a sale while there is a willing purchaser may pressure the parties or the court to accept a sale.²¹⁶ Further, due to the speed of many § 363(b) sales, full inquiry into the facts of the bankruptcy or the terms of the sale may not be possible.²¹⁷ For these reasons, parties may invoke the justification so their agreement will be subject to more relaxed review and the sale will be more likely to proceed.

Research has shown that unsecured creditors and equity holders are often placed in a worse position in a § 363(b) sale than they would be in a plan confirmation.²¹⁸ At the same time secured creditors and priority creditors are often placed in a superior position, possibly due to their involvement in the drafting of the sale agreement and also due to the money saved by averting a drawn out bankruptcy.²¹⁹ Because of the quick timeline,

209. *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983).

210. *See, e.g., In re Chrysler LLC (Chrysler I)*, 405 B.R. 84, 96 (Bankr. S.D.N.Y. 2009) (discussing how proponents of the sale made a showing that the sale was necessary for the preservation of the estate, that no other purchasers were available even after extensive search and that the creditors were receiving a large portion of the distribution just like in a liquidation).

211. 11 U.S.C. § 1129(7)(A)(ii) (2006).

212. *See Chrysler I*, 405 B.R. 84 (showing was made that there was an extensive search made for purchasers and only Fiat was willing to be involved); *In re General Motors Corp.*, 407 B.R. 463, 480–81 (Bankr. S.D.N.Y. 2009) (showing was made that there were no other purchasers available and willing to acquire the company).

213. *See, e.g., Chrysler I*, 405 B.R. at 480.

214. *See, e.g., Lionel*, 722 F.2d at 1071.

215. *See Rose, supra* note 22, at 270–71 (“[T]he court is reluctant to scrutinize quick transactions since a denial would risk irreparable diminished payouts to creditors.”).

216. *See id.* at 271.

217. *See* George W. Kuney, *Misinterpreting Bankruptcy Code 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L.J. 235, 279–80 (2002).

218. *See id.* at 275–80 (indicating that secured and priority creditors benefit from expedited sales while other creditors are placed at a disadvantage).

219. *See id.*

limited access to information, and lack of involvement in the drafting of the sale, it is questionable whether impaired parties can meaningfully object in a “time is of the essence” § 363(b) sale hearing.²²⁰

The other major problem with a “time is of the essence” sale is that it precludes an effective market test.²²¹ Where urgency is present, market participants either cannot formulate a bid or their offers will be rejected to maintain a current secured offer.²²²

“Time is of the essence” sales are appealing for the purchasing party because of this limited scrutiny and likely sale.²²³ However, the sale is susceptible to abuse and increases the likelihood of “sweetheart” deals accruing unfair benefits to the purchaser and insiders.²²⁴ A requirement that the proponent of a “time is of the essence” sale show a compelling necessity is needed to counteract the lack of a market test and limited ability of creditors to object;²²⁵ the need for a quick sale should heighten scrutiny not diminish it.

Courts should inquire into the efforts made to sell the company and require disclosure of any offers for its purchase. This will be necessary to not only analyze whether better offers are available but also what actions were taken to sell the company and whether future offers are likely.²²⁶ If the “drop dead date” is sufficiently far in the future, the market test should supplement this showing. To make this showing, the proponent should show that the debtor engaged in bidder shopping and establish that despite the special privileges of § 363(b), a new purchaser would not come forward.

Review of the reason for the impending deadline, while not dispositively establishing the credibility of the threat, may reveal an attempt to subvert the system.²²⁷ If a “drop dead date” does not relate to a valid business reason, the court should engage in or strengthen the substantive review of the sale.

220. See Rose, *supra* note 22, at 260.

221. See discussion *supra* Part III.A.2.

222. See discussion *supra* Part III.A.2.

223. See, e.g., *In re Enron Corp.*, 291 B.R. 39, 43 (S.D.N.Y. 2003) (vacating sale order of Bankruptcy Court because it failed to adequately scrutinize the sales procedure and relied on the “debtors’ business judgment”).

224. See George W. Kunej, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 108–09 (2004).

225. See Rose, *supra* note 22, at 284 (analyzing the shortened timeframe and limited disclosure in § 363(b) sales that hinder the ability of creditors to effectively object to the sale).

226. See, e.g., *In re Chrysler LLC (Chrysler I)*, 405 B.R. 84, 90 (Bankr. S.D.N.Y. 2009) (considering whether Chrysler was in discussions and negotiations for an alliance with multiple manufacturers).

227. See Rose, *supra* note 22, at 280 (analyzing how debtor’s claim in *Polaroid* case received the “maximum value” from the initial bid and that bidding should have been closed was debunked by subsequent bids for nearly twice the value, thereby indicating possible insider and unfair dealings).

2. INDEPENDENT COURT REVIEW FOR FRAUD AND SELF-DEALING

In “time is of the essence” § 363(b) sales, review by creditors is limited, full disclosure is ineffective or impossible, and a market test is effectively avoided.²²⁸ As such, procedural impediments to abuse are rendered ineffective. In order to instill credibility and deter abuse, the sale agreement must be subject to review by the courts; this provides a reasonable, though imperfect, substitute for a market test.²²⁹

The court or the United States trustee should independently review “time is of the essence” sales to ensure against fraud. Finding that the terms are fair and not the product of abuse will prevent insiders selling to the purchaser for below market value in return for side benefits.²³⁰ The mere fact of the review may also deter parties from engaging in side dealing or “sweetheart deals” because the court will be aware of and look for such favorable terms.

First, in much the same way that disclosure requirements in areas such as securities law deter fraud and self-dealing, court review should deter proponents of § 363(b) sales from engaging in abuse.²³¹ This “substantive fairness”²³² review will not likely affect results that are at the margin of reasonable purchases, but it may reveal abuse in egregious cases.

Second, the substantive review may provide insight into the bidding process and increase the likelihood that another purchaser will come forward.²³³ This information can be evaluated along with the record provided by the § 363(b) proceedings to supplement an analysis of the sale’s necessity. If a plan seems “too good to be true,” the court may require the sale to be pushed back and a market test ordered.

228. See discussion Part III.B (discussing how shortened time frame of “time is of the essence” sales precludes meaningful opposition).

229. Courts have, on occasion, instituted substantive review of § 363(b) sales to ensure against self dealing, undervaluation and other abuses. See, e.g., *In re Enron Corp.*, 291 B.R. 39, 41–43 (S.D.N.Y. 2003); *In re Bidermann Indus. U.S.A., Inc.*, 203 B.R. 547, 552–54 (Bankr. S.D.N.Y. 1997) (finding that leveraged buyout agreement could not be approved due to conflicts of interest, self-dealing, and improper bidding procedures).

230. See LoPucki & Doherty, *supra* note 22, at 32–33 (finding that in eleven out of thirty studied reorganizations, the CEO of the selling company was able to secure a side benefit, such as severance payments, continued employment or a paid consulting position).

231. See generally Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 808–09 (2001) (discussing disclosure requirements that facilitate discovery, review, and regulation of self-dealing transactions).

232. See *id.* (discussing how in securities regulation, review by independent parties such as independent corporate directors, regulators, and judges deters self-dealing and illicit transactions and promotes correction through channels such as shareholder derivative suits).

233. See Rose, *supra* note 22, at 281–82 (discussing how the ability of debtors or purchasers to manipulate market forces through deal protection fees, limited release of information, and limited bidder participation requires judicial oversight to ensure proper valuation of assets).

While such review cannot replace a market test, this heightened scrutiny will facilitate the bankruptcy judge's power in such emergency situations to prevent or at least limit abuse.

CONCLUSION

The *Chrysler* and *General Motors* cases indicate that the use of § 363(b) sales is important and relevant.²³⁴ The impact of these sales will be felt widely in bankruptcy proceedings, out-of-court workouts, and in corporate meetings throughout America.²³⁵

Commercial transactions operate in the “shadow of the law”²³⁶ and remains unclear what impact the automotive bankruptcies will have on commercial decisions in the future. However, lenders—such as those that were negatively impacted by the two companies filing for bankruptcy and resorting to § 363(b) sales—are vital to a thriving economy;²³⁷ they take into account the risks associated with businesses filing for bankruptcy and allocate future capital accordingly.²³⁸ Even assuming that creditors in the *General Motors* and *Chrysler* cases were provided with as large of a payout as they would have received in a plan confirmation, their loss of control over the process may have had a negative impact on lenders generally and may chill lending to distressed or even healthy businesses.²³⁹ This, coupled with concerns over abuse, fraud, and self-dealing, provides a compelling reason to safeguard creditors and curtail the use of § 363(b) sales.²⁴⁰

234. See Adler, *supra* note 14, at 305–06 (discussing the precedential impact of the *Chrysler* and *General Motors* cases).

235. See Roe & Skeel, *supra* note 177, at 770 (“The unevenness of the compensation to prior creditors [in *Chrysler*] raised considerable concerns in capital markets.”).

236. See generally Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979) (discussing divorce law, providing an in depth analysis of the effect of laws on private decisions, and detailing the phenomenon of society functioning in the “shadow of the law”).

237. Barack H. Obama, President, United States, Remarks to Joint Session of Congress (Feb. 24, 2009), http://www.whitehouse.gov/the_press_office/Remarks-of-President-Barack-Obama-Address-to-Joint-Session-of-Congress.

[T]he flow of credit is the lifeblood of our economy. The ability to get a loan is how you finance the purchase of everything from a home to a car to a college education; how stores stock their shelves, farms buy equipment, and businesses make payroll. . . .

When there is no lending, families can't afford to buy homes or cars. So businesses are forced to make layoffs. Our economy suffers even more, and credit dries up even further.

Id.

238. See generally Robert K. Rasmussen, *Behavioral Economics, the Economic Analysis of Bankruptcy Law and the Pricing of Credit*, 51 VAND. L. REV. 1679 (1998).

239. See Adler, *supra* note 14, at 311 (“[W]hen the bankruptcy process deprives a creditor of its promised return, the prospect of a debtor's failure looms larger in the eyes of future lenders to future firms.”).

240. See Rose, *supra* note 22, at 284.

On the other hand, § 363(b) sales provide undeniable benefits to struggling businesses and their stakeholders.²⁴¹ A solution that combines these benefits—such as speed and efficiency—with the plan confirmation’s democratic protections can improve the system by protecting creditors without limiting the bankruptcy judge’s discretion.²⁴² Providing a meaningful robust market test will contribute such improvement. The market test helps to ensure that the price paid for the business is fair, that there is no inside dealing, and that creditors are benefited by the sale.²⁴³ If a market test is impractical because “time is of the essence,” heightened scrutiny of the sale will safeguard against the same factors and work to prevent the abuse of creditors.²⁴⁴

While this proposal is not presented as a panacea for the bankruptcy system, or even for all of the problems associated with § 363(b) sales, it intends to demonstrate that the debate between proponents of Chapter 11 plan confirmations and those of § 363(b) sales should not be viewed as an either/or conflict. Both processes have a great deal to offer a distressed business and its creditors; both also have significant drawbacks, not only to the debtor and creditors, but to the system.²⁴⁵ By crafting a solution that attempts to take advantage of the best aspects from each, the parties, the system, and the community at large all benefit.

However, such a solution raises problems and questions of its own. How does a court determine whether the period for the market test is adequate? When proposed sales differ by terms other than price, who decides which plan is superior and what criterion are used? Under what circumstances should a market test be found to be cost prohibitive? Further inquiry is also necessary to assess whether the tradeoffs of disclosure—including deterring possible purchasers—will be outweighed by the benefits of deterring abuse and having parties analyze the transaction. Nor is a judge’s inquiry into the risk of, or fear of denying a “time is of the essence” sale, alleviated. Further, such a proposal will not prevent parties from

Fraudulent § 363 preplan business sales undermine the principles and policies that govern our bankruptcy system. In evaluating the impact of these § 363 preplan business sales, we must recognize what is at stake. The finality of the sales, the integrity of the bankruptcy system, and the people that are harmed by sweetheart deals and management’s greed justify a substantial limitation on the process and opportunity of § 363 preplan business sales.

Id.

241. See discussion *supra* Part II.

242. Multiple provisions in the Bankruptcy Code demonstrate the necessity of granting bankruptcy judges wide discretion in their duties, including the ability to order a sale with limited appealability under § 363 or the inherent equitable powers granted to the court in § 105. See 11 U.S.C. §§ 105, 363 (2006).

243. See discussion *supra* Part III.A.

244. See discussion *supra* Part III.B.

245. See discussion *supra* Part II.

attempting to “game the system”²⁴⁶ by creating innovative solutions to benefit themselves at the expense of others.

Even if a perfect solution is unattainable, the project is still a worthy one. Improving the bankruptcy system and what it stands for, as attorneys, academics, Congress, and the courts have been doing for two centuries, is reason enough to continue to search for solutions for new problems as they arise. Perhaps by improving the system, perfection may be achieved, for in the words of Sir Winston Churchill, “[t]o improve is to change; to be perfect is to change often.”²⁴⁷

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246. See JAMES B. RIELEY, GAMING THE SYSTEM: HOW TO STOP PLAYING THE ORGANIZATIONAL GAME, AND START PLAYING THE COMPETITIVE GAME xii–xiii (2001). Gaming the system refers to a process in which an individual uses the rules and procedures of a system for self benefit and in a way in which they were not intended. See *id.* (describing how players attempting to subvert the system by following the letter of the law while going against its spirit provides for detrimental long term effects).

247. STEPHEN MANSFIELD, NEVER GIVE IN: THE EXTRAORDINARY CHARACTER OF WINSTON CHURCHILL 118 (George Grant ed., 1995).

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