BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM

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Abstract

The Chrysler and General Motors (GM) bankruptcy reorganizations represent the culmination of a sea-change in corporate restructuring practice that has occurred largely over the course of just the past decade. A bankruptcy reorganization has traditionally been effectuated though a chapter 11 plan of reorganization, with elaborate requirements for disclosure, creditor voting, and allocation of stakes in the reorganized debtor entity's new capital structure among creditors and owners. Such an internal boot-strap reorganization, though, is on the decline, and many reorganizations are now accomplished through a relatively expeditious going-concern sale of the debtor's business and assets to a third-party purchaser, with a subsequent distribution of the proceeds to creditors and shareholders in accordance with their relative priority rights.

What Chrysler and GM vividly illustrate is that there actually is no clean, clear distinction between reorganization by "plan" and reorganization by "sale"—through the wonders of sophisticated transaction engineering, each can be the precise functional equivalent of the other. The acute danger this presents, and that actually came to pass in the GM case, is that a nominal "sale" structure can be used to effectuate a purely internal boot-strap reorganization that distributes the value of the reorganized debtor entity among creditors in a manner that indisputably contravenes their relative priority rights in the debtor's assets. Indeed, when examined in the context of a longer historical perspective on corporate reorganizations, one can readily discern that what transpired in GM (and what the Second Circuit's Chrysler opinion fully sanctions) is precisely what the Supreme Court prohibited in a series of decisions in the late 1800s and early 1900s, which formed the basis for chapter 11's codification of creditors' priority rights in corporate reorganizations.

Contrary to the received wisdom regarding the implications of Chrysler and GM, their combined effect foretells the literal death of the fundamental distributive principles that are the essence of bankruptcy law and that have been the bedrock of bankruptcy reorganizations for at least a century. Moreover, no one (and particularly not the judges presiding over those cases) seems to appreciate that fact! Amazingly, we find ourselves in the midst of a sub silentio destruction of the very core of bankruptcy reorganization law.

Key words

bankruptcy reorganizations, Assets, Estate Value, proposed sale, creditors

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Introduction

Few (if any) bankruptcy reorganizations in our history have been as important to the U.S. economy or have attracted as much notoriety as the 2009 restructurings of Chrysler and General Motors (GM). At stake were literally billions of dollars and hundreds of thousands of jobs. In stunning succession, first Chrysler (in 41 days[1]) and then GM (in 39 days[2]) rocketed through chapter 11 in a dizzying display of initiative, ingenuity, and power. Historians likely will mark the *Chrysler* and *GM* cases as two of the biggest success stories of the Obama administration. For but a measly few billion dollars, the American automotive industry, and at some level even the U.S. economy, were saved, bringing us hope at a time of despair while mired in the throes of the Great Recession.

Those left to toil in the vineyards of corporate restructuring, though, must contend with the "law" produced by these two historic cases. Although one might with considerable justification argue that *Chrysler* and *GM* were *sui generis*—and as a matter of law should be politely and discreetly ignored as once-in-a-century aberrations having more to do with political and economic necessity than with legal precedent that anyone should take seriously—we suspect (indeed, to a virtual certainty) that such will not be the case. The decisions rendered by the influential and respected federal courts in New York were framed as being squarely within the mainstream of current accepted bankruptcy convention[3] and undoubtedly will be happily embraced and submitted as gospel in future cases by the sophisticated elite of the reorganization bar, who themselves crafted the very practices approved by the *Chrysler* and *GM* courts.[4] In short, we have no choice but to take stock of where we stand in reorganization law and practice after *Chrysler* and *GM*.

The legacy of *Chrysler* and *GM* for the future of bankruptcy reorganizations is potentially pernicious, although not for the litany of reasons commonly proffered. Two interrelated aspects of those cases provoke debate. First, each was effected through the guise of a "sale" of substantially all of the

1.Chrysler filed its bankruptcy case on April 30, 2009, and the final sale closed on June 10, 2009. *In re* Chrysler LLC, 576 F.3d 108, 111–12 (2d Cir. 2009).

2.GM filed chapter 11 on June 1, 2009, and the final sale closed on July 10, 2009. *In re* Gen. Motors Corp., 407 B.R. 463, 479 (Bankr. S.D.N.Y. 2009); Gen. Motors Co., Current Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 8-K), at 2 (July 16, 2009).

3. *See In re* Chrysler LLC, 405 B.R. 84, 97–100 (Bankr. S.D.N.Y. 2009), *aff'd*, 576 F.3d 108 (2d Cir. 2009), *vacated as moot sub nom.* Ind. State Police Pension Trust v. Chrysler LLC, 130 S. Ct. 1015 (2009); *Gen. Motors*, 407 B.R. at 495–98.

4. Professor Lubben's defense of the *Chrysler* and *GM* sales as (evidently) entirely unproblematic provides a representative example. Stephen J. Lubben, *No Big Deal: The* GM *and* Chrysler *Cases in Context*, 83 AM. BANKR. L. J. 531 (2009).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

debtor's assets (pursuant to § 363 of the Bankruptcy Code[1]), rather than pursuant to a "plan" of reorganization. The fundamental concern with using sales in lieu of plans is that economic stakeholders will be deprived of the carefully crafted protections—both substantive and procedural—embodied in chapter 11's plan confirmation rules. The still-accepted legal test for approving a § 363 sale of substantially all assets was announced in the Second Circuit's 1983 decision *In re Lionel Corp.*: "a good business reason" must be put forward for the sale,[2] and that reason must answer the question of "why can't we wait for a plan?"[3] Prior examples of sales meeting this test include the approval of a quick sale of a skeletal hotel property to permit the hotel's completion before the start of the nearby 1964 World's Fair[4] and, more quaintly, the sale of a stock of handkerchiefs just in time for the Christmas sales season.[5]

The basic "sales are suspect" concern, we submit, is largely yesterday's news and can and should be readily disposed of—with the very important caveat that bankruptcy judges considering § 363 sales should be wary of the clever and surreptitious end-runs around chapter 11's *distributional norms* lurking in the auto cases (especially *GM*) that we will highlight. But there is nothing about capturing reorganization value via a § 363 sale rather than through a plan that is in itself problematic. Indeed, the reality of chapter 11 practice has long since moved to the sale norm, and we do not advocate a retreat.

The second, and related, concern about using § 363 sales rather than plans to capture reorganization value is determining whether the supposed "sale" is in fact not just a sale, but instead "is in reality a 'reorganization' masquerading in 'sale' clothing."[6] Although a rose by any other name may smell as sweet, if a chapter 11 debtor is proposing a full-blown reorganization, and not just a sale of assets, it must and it should have to comply with the Bankruptcy Code's detailed plan confirmation rules, rather than the more modest sale approval rules. This concern typically travels under the rubric that the sale of the debtor's assets under § 363 cannot be a "*sub rosa*" plan of reorganization.[7] The leading case denouncing *sub rosa* plans was the Fifth Circuit's 1983 decision *In re Braniff Airways, Inc.*[8] The bankruptcy courts in both *Chrysler*[9] and *GM*[1] held that the sales were simply sales and *not* impermissible *sub*

5.11 U.S.C. § 363 (2006).

2.Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.) 722 F.2d 1063, 1071 (2d Cir. 1983).

3. *See id.*

4. *In re* Sire Plan, Inc., 332 F.2d 497, 498–99 (2d Cir. 1964).

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

6. CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY § 5.17, at 459 (2d ed. 2009).

7. *See* Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983).

8. *Id.*

9. *In re* Chrysler LLC, 405 B.R. 84, 97–100 (Bankr. S.D.N.Y. 2009).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

rosa reorganization plans. Moreover, the Second Circuit issued an expedited opinion affirming the *Chrysler* decision that also specifically rejected the argument that the Chrysler § 363 sale was an impermissible *sub rosa* plan of reorganization.[2]

Our primary concern about the legacy of *Chrysler* and *GM* does not dwell on either the "sales are suspect" or on the *sub rosa* plan problem (although we will explain how the Second Circuit in *Chrysler* essentially ignored the latter problem by collapsing it into the former and using an undifferentiated "good business reason" test to address both issues). Instead, our fundamental worry, which has largely escaped notice in the furor over the "sale versus plan" debate, is that the courts in *Chrysler* and especially *GM* fell for a venerable reorganization fallacy about distributional norms and (non)entitlements that we thought was definitively laid to rest by the Supreme Court in the foundational case *Northern Pacific Railway Co. v. Boyd*[3] in 1913! If this fallacy is not exposed and rejected, then clever reorganization lawyers will be able to circumvent at will the distributional principles that lie at the very core of chapter 11, in precisely the same way that reorganization lawyers did a century ago (until finally stopped by the Supreme Court in *Boyd*). The abuses of the federal equity receiverships that dogged reorganization practice in a bygone century will be resurrected under the cloak of § 363 sales. If such a drastic abandonment of established chapter 11 norms is to occur, it would at least be slightly more palatable if courts fully understood and forthrightly acknowledged the destruction of positive law they are working.

The heart of the matter is this: whether reorganization value is captured by "sale" or by "plan" is not the critical question, as long as the method chosen preserves and upholds chapter 11's distributional norms. Given that any particular "plan" can be structured as a "sale," and any "sale" can be effectuated through a "plan" structure,[4] it may simply be impossible to meaningfully distinguish between the two—through some sort of "true sale" versus "true reorganization" construct—in a manner that can preserve those distributional

1. *In re* Gen. Motors Corp., 407 B.R. 463, 495–98 (Bankr. S.D.N.Y. 2009).
2. *In re* Chrysler LLC, 576 F.3d 108, 117–19 (2d Cir. 2009).
3. 228 U.S. 482 (1913).
4. *See* Ralph Brubaker, *Taking Exception to the New Corporate Discharge Exceptions*, 13 AM. BANKR. INST. L. REV. 757, 770–71 (2005). Indeed, this truism has recently made clear the necessity of a correlative, converse notion of the *sub rosa* sale in order to preserve the integrity of chapter 11's sale rules. *See* Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 245 (5th Cir. 2009). *See generally* Ralph Brubaker, *Cramdown of an Undersecured Creditor Through Sale of the Creditor's Collateral: Herein of Indubitable Equivalence, the § 1111(b)(2) Election, Sub Rosa Sales, Credit Bidding, and Disposition of Sale Proceeds*, BANKR. L. LETTER, Dec. 2009, at 1, 4–5 [hereinafter Brubaker, *Cramdown*].

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

norms.[1] We submit, therefore, that courts confronting these issues must keep their primary focus on the core need to protect the normative distributional entitlements of stakeholders, whether the reorganization proceeds by sale or plan. If the mechanism used impairs or obstructs the court's ability to fulfill that central protective role, then and only then should the court reject the reorganization vehicle. Analysis of the *Chrysler* and *GM* sales from this perspective reveals that the *Chrysler* sale ultimately did *not* threaten stakeholders' distributive entitlements and, thus, was properly approved (although not for the reasons articulated by the Second Circuit). But, the *GM* sale (with aid and comfort from the Second Circuit's affirmance of the *Chrysler* sale) was a "Trojan horse" assault on chapter 11's distributional norms, and unless it is recognized and acknowledged as such, *GM* threatens the continuing integrity and viability of those core distributive principles.

Full exploration of the "sale versus plan" problem implicates first principles of bankruptcy reorganization law, theory, history, and practice, and forces us to confront the fundamental distributional questions that are the essence of bankruptcy law. *Chrysler* and especially *GM*—because they highlight the logical extremes to which prevailing § 363 sale practice can be pushed, and how transaction structure can be engineered to divert the court's attention away from stakeholders' central distributive entitlements—give us cause to collectively reflect on that which the turn from chapter 11 plans to chapter 11 sales has wrought. Doing so, though, first requires getting inside the deal structure of each case.[2]

I. The structure of the chrysler and gm "sales"

A. *Chrysler*: A $2 Billion Sale Free and Clear of Underwater Prepetition Senior Secured Debt

The background to the *Chrysler* and *GM* sales is, of course, that the global credit crisis in the fall of 2008, and the ensuing worldwide economic contraction, hit the U.S. automotive industry particularly hard, necessitating direct U.S. government intervention in late 2008 to sustain ongoing operations for both auto makers. In the case of Chrysler, governmental assistance came in the form of a $4 billion loan from the U.S. Department of the Treasury (U.S. Treasury).[3] Chrysler's preexisting senior lenders, owed approximately $6.9 billion, were secured by liens on substantially all of Chrysler's assets, and

1. For a thoughtful attempt to draw this line, though, see Mark J. Roe & David Skeel, *Assessing the* Chrysler *Bankruptcy*, 108 MICH. L. REV. 727, 751–56 (2010).
2. For a careful analysis of the deal in each case, see A. Joseph Warburton, *Understanding the Bankruptcies of* Chrysler *and* General Motors*: A Primer*, 60 SYRACUSE L. REV. 531, 533–39 (2010).
3. John D. Stoll & Monica Langley, *Auto Maker Bankruptcy Looms*, WALL ST. J., Feb. 17, 2009, at A1.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

Chrysler also owed an additional $2 billion to subordinated secured lenders who held second-priority liens on those same assets.[1] The government's initial loan, therefore, was nominally "secured" by a first-priority lien only on any unencumbered Chrysler assets and by a third-priority lien on all other assets.[2]

The government's initial loan required Chrysler to submit a long-term viability plan demonstrating Chrysler's ability to repay the loan.[3] Since early 2007, Chrysler had been pursuing an operational restructuring that included a comprehensive search for a strategic alliance with another manufacturer that could provide Chrysler with a more global presence and expertise in smaller, more fuel-efficient vehicles.[4] This led to serious discussions with Fiat, and those discussions intensified as Chrysler's finances became more dire.[5] The viability plan that Chrysler submitted to the government in February 2009 laid out three alternative scenarios: (a) a stand-alone restructuring with negotiated concessions from all stakeholders, (b) implementation of a strategic alliance with Fiat, or (c) an orderly wind-down of Chrysler's operations.[6]

In late February, President Obama appointed his Auto Task Force to evaluate Chrysler's viability options and to negotiate with Chrysler constituencies.[7] The Task Force, advised by teams of top-flight professionals, including investment bankers and bankruptcy and restructuring attorneys, ultimately concluded that the Fiat alliance was Chrysler's most advantageous alternative.[8] The government indicated that it would, subject to certain conditions, provide necessary financing for that alliance, to be implemented through a chapter 11 bankruptcy filing.[9] Negotiations with Fiat and Chrysler stakeholders ultimately produced a sale agreement dated April 30, 2009, the same day that Chrysler filed its chapter 11 petition.[10]

The bankruptcy court approved the proposed sale by order dated May 31, 2009.[11] This was followed by a brief interlude of high drama in which both

1. CHRYSLER, CHRYSLER RESTRUCTURING PLAN FOR LONG-TERM VIABILITY 16 (2009), http://graphics8.nytimes.com/images/2009/02/17/business/ChryslerRestructuringPlanFull.pdf.
2. *Id.*
3. Stoll & Langley, *supra* note 20.
4. *In re* Chrysler LLC, 405 B.R. 84, 90 (Bankr. S.D.N.Y. 2009); CHRYSLER, *supra* note 21, at 23.
5. *Chrysler*, 405 B.R. at 90.
6. CHRYSLER, *supra* note 21, at 11.
7. *Chrysler*, 405 B.R. at 91.
8. Press Release, The White House, Obama Administration Auto Restructuring Initiative: Chrysler-Fiat Alliance (Apr. 30, 2009), *available at* http://www.whitehouse.gov/the_press_office/obama-administration-auto-restructuring-initiative.
9. *Id.*
10. *In re* Chrysler LLC, 576 F.3d 108, 111–12 (2d Cir. 2009).
11. *Chrysler*, 405 B.R. at 113.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

the Second Circuit[1] and then Justice Ginsburg[2] stayed consummation of the sale. In its expedited direct appeal, though, the Second Circuit summarily affirmed the bankruptcy court's approval of the sale on June 5,[3] and Justice Ginsburg's June 8 stay was vacated by the full Supreme Court the next day.[4] The sale was then closed on June 10, 2009.[5]

The government funding of the Fiat alliance came from both the U.S. and Canadian governments, through $5 billion of postpetition debtor-in-possession (DIP) financing for a period of 60 days and an additional $6 billion of senior secured financing for "New Chrysler."[6] The Fiat alliance was implemented through a purchase-and-sale structure, with the purchaser being a newly created LLC acquisition entity (New Chrysler).[7] Ownership of New Chrysler was distributed between the U.S. and Canadian governments, Fiat, and a preexisting Voluntary Employees' Beneficiary Association (VEBA) trust established to pay healthcare obligations to Chrysler retirees.[8]

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1. *See In re* Chrysler LLC, No. 09-2311-mb, 2009 WL 1532960 (2d Cir. June 2, 2009) (granting leave for direct appeal); *In re* Chrysler LLC, No. 09-2311-mb, 2009 WL 1532959 (2d Cir. June 2, 2009) (staying sale order).

2. Ind. State Police Pension Trust v. Chrysler LLC, 129 S. Ct. 2275 (2009) (mem.) (Ginsburg, J.), *vacated per curiam*, 129 S. Ct. 2275 (2009).

3. The Second Circuit heard oral argument on June 5 "and ruled from the bench and by written order, affirming the Sale Order 'for the reasons stated in the opinions of Bankruptcy Judge Gonzalez,' stating that an opinion or opinions would follow." *Chrysler*, 576 F.3d at 111.

4. *Ind. State Police Pension Trust*, 129 S. Ct. at 2276 (per curiam).

5. *Chrysler*, 576 F.3d at 112.

6. *Id.*

7. *Id.* at 111–12.

8. The specific distributions were as follows:

1.The governmental entities funding New Chrysler received 12.31% of the LLC membership interests (9.85% for the U.S. Treasury and 2.46% for Export Development Canada (EDC)).

2.Fiat's contribution to New Chrysler of technology, vehicle platforms, management expertise, distribution capabilities, and cost-saving opportunities garnered it 20% ownership of New Chrysler, with the ability to ultimately achieve 51% ownership (through a right to purchase an additional 16%, and an additional 15% through incentive-based ownership, accruing upon accomplishment of specified benchmarks). Fiat is precluded, though, from acquiring majority ownership of New Chrysler until the $6 billion owed to the U.S. and Canadian governments is fully repaid.

3.Finally, 55% ownership was vested in the trust previously established to pay healthcare obligations to Chrysler retirees. This trust was initially established through a March 2008 settlement with the UAW in a class action to enforce Chrysler's obligation to fund retiree healthcare benefits and was qualified as a voluntary employees' beneficiary association (VEBA) under the Internal Revenue Code. In addition to its 55% ownership of New Chrysler, the Chrysler VEBA also received a new $4.587 billion note from New Chrysler.

In re Chrysler LLC, 405 B.R. 84, 92 & n.11 (Bankr. S.D.N.Y. 2009).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

New Chrysler purchased substantially all of Old Chrysler's operating assets for $2 billion in cash plus assumption of specified Old Chrysler liabilities.[1] This purchase was made free and clear of all liens and debts of Old Chrysler (including those that might otherwise be asserted against New Chrysler by way of successor liability doctrines), except for those specifically assumed by New Chrysler, pursuant to § 363(f) of the Bankruptcy Code.[2] Old Chrysler assumed and assigned specified contracts and leases (including specified dealership agreements[3]) to New Chrysler, and New Chrysler entered into a new collective bargaining agreement with the auto workers union (UAW), establishing a new wage structure and work rules.[4] Given that Old Chrysler's prepetition senior secured lenders were owed $6.9 billion, they received the entirety of the $2 billion purchase price.[5] All other prepetition creditors whose debts were not affirmatively assumed by New Chrysler accordingly will receive nothing (or next to nothing, i.e., whatever the Old Chrysler estate can squeeze out of the unencumbered assets not sold, such as preferential transfer avoidance actions under § 547 of the Bankruptcy Code[6]).

B. GM: A Credit-Bid Sale to Underwater Senior Secured Lenders

The structural differences between the *Chrysler* and *GM* asset sales are largely explained by the different types of debt in place at the time of the U.S. government's intervention, which in turn explains the differing vehicles employed to implement that U.S. government funding. Unlike Chrysler, which was heavily encumbered by secured debt, GM's debt structure was dominated by $27 billion in unsecured public bond debt.[7] Thus, when the U.S. Treasury provided GM with a $13.4 billion credit facility in December 2008, this financing was on a senior secured basis, with first liens on many of GM's assets and second liens on the collateral of existing secured lenders (and intercreditor agreements to preserve these lenders' priority).[8]

GM was also required under the terms of the government loan to submit a viability plan, which was reviewed by the Auto Task Force.[9] On

1. *Chrysler*, 576 F.3d at 112.
2. 11 U.S.C. § 363(f) (2006); *Chrysler*, 405 B.R. at 113.
3. Christopher Scinta et al., *Chrysler Asks Leave to Cancel 789 Dealer Agreements*, BLOOMBERG.COM, May 14, 2009, http://www.bloomberg.com/apps/news?pid=20601087&sid=ayv7Vwsy1QRo&refer=home.
4. John D. Stoll & Jeff Bennett, *Chrysler, UAW Amend Labor Pact to Cut Costs*, WALL ST. J., Apr. 27, 2009, at B1.
5. *Chrysler*, 576 F.3d at 123; *Chrysler*, 405 B.R. at 89.
6. 11 U.S.C. § 547.
7. *In re* Gen. Motors Corp., 407 B.R. 463, 473–74 (Bankr. S.D.N.Y. 2009).
8. *Id.* at 477–78.
9. *Id.* at 477.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

March 30, 2009, however, President Obama announced that GM's viability plan was not satisfactory.[1] This determination not only threatened to bar additional government funding, it also made the government's initial loan due and payable in full, by its terms, on April 30.[2] This threat of imminent liquidation was an effective prod toward a more aggressive restructuring to be brokered by the government and to be implemented through a chapter 11 filing contemplating an expeditious sale transaction. On this understanding, the government advanced GM an additional $6 billion of interim operating credit through the end of May, bringing the government's total prepetition senior secured loans to $19.4 billion.[3]

GM filed its chapter 11 petition on June 1 and, on the same day, filed its proposed sale transaction under § 363.[4] Senior secured postpetition DIP financing of $33.3 billion was provided by the U.S. and Canadian governments ($24.2 billion from the U.S. Treasury and $9.1 billion from Export Development Canada (EDC)) but was conditioned on approval of the sale transaction by July 10.[5] The bankruptcy court entered its order approving the sale on July 5,[6] and separately denied requests for a stay pending appeal.[7] On July 9, the district court also denied stay requests,[8] and the sale closed, as required, on July 10.[9]

The GM sale also was accomplished via a newly formed acquisition entity (New GM). Ownership in New GM was distributed principally to the U.S. and Canadian governments, and, out of the residue, UAW retirees received a much larger share than other unsecured creditors.[10] As in *Chrysler*, New GM

1. *Id.* at 478–79; *see also* President Barack Obama, Remarks by the President on the American Automotive Industry (Mar. 30, 2009) (transcript available at http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-American-Automotive-Industry-3/30/09).
2. *See Gen. Motors*, 407 B.R. at 478.
3. *Id.* at 479.
4. Debtors' Motion Pursuant to 11 U.S.C. §§ 105, 363(b), (f), (k), and (m), and 365 and Fed. R. Bankr. P. 2002, 6004, and 6006 *Gen. Motors*, 407 B.R. 463 (No. 09-50026), 2009 WL 1529573.
5. *Gen. Motors*, 407 B.R. at 480; Exhibit A: Draft DIP Facility, *Gen. Motors*, 407 B.R. 463 (No. 09-50026), 2009 WL 4715903.
6. *Gen. Motors*, 407 B.R. at 463.
7. *In re* Gen. Motors Corp., 409 B.R. 24, 34–35 (Bankr. S.D.N.Y. 2009).
8. *In re* Gen. Motors Corp., No. 09-50026, 2009 WL 2033079 (S.D.N.Y. July 9, 2009).
9. Gen. Motors Co., Current Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 8-K), at 2 (July 16, 2009).
10. The precise allocation of ownership interests in New GM was as follows:

1.The U.S. Treasury received 60.8% of New GM's common stock and $2.1 billion of New GM Series A Preferred Stock.

2.EDC received 11.7% of New GM's common stock and $400 million of New GM Series A Preferred Stock.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

purchased substantially all of Old GM's assets.[1] Unlike *Chrysler*, though, there was no cash consideration paid by New GM in order to purchase the assets of Old GM. Rather, the U.S. and Canadian governments assigned to New GM (in exchange for their common and preferred stock therein) their right to credit bid the bulk of their secured claims under both the prepetition U.S. Treasury secured loan and the postpetition DIP loans.[2] The "purchase price" paid to Old GM by New GM, therefore, consisted of the credit bid, New GM common stock and warrants, and assumption of certain specified Old GM liabilities, including $6.7 billion of the DIP facility.[3] Moreover, because the governments' liens were second liens with respect to some assets, the credit-bid sale was "subject to" any prior liens, and New GM assumed all of Old GM's nongovernmental secured debt.[4]

As in *Chrysler*, Old GM assumed and assigned specified contracts to New GM, including a revised collective bargaining agreement with the UAW.[5] Unlike the fate that has befallen Chrysler's prepetition unsecured creditors whose debts were not specifically assumed by New Chrysler (i.e., no recovery), however, GM's prepetition unsecured creditors (including the $27 billion of bondholders and GM dealers whose franchise agreements were rejected) will share in the New GM common stock "paid" to Old GM.[6]

II. Selling Assets and Making Distributions Outside of a Plan of Reorganization: What Is the Essence of "Reorganization"?

A. Preplan § 363 Sales of Substantially All Assets: Maximizing Aggregate Estate Value

The *sub rosa* plan issue is easily (and thus frequently) collapsed into (and confused with) the more general preliminary question of whether and when a § 363 sale of substantially all of a debtor's assets is (or should be) permissible in a chapter 11 case. To separate this issue from the *sub rosa* plan issue, though,

3.A new VEBA, formed solely to pay UAW retiree benefits, received 17.5% of the common stock, $6.5 billion of the Series A Preferred Stock, and a warrant to purchase an additional 2.5% of the common stock.

4.Old GM received 10% of the common stock, to be distributed to Old GM creditors under any confirmed plan of reorganization. Old GM is to receive an additional 2% of the GM common stock if allowed general unsecured claims against Old GM exceed $35 billion. In addition, Old GM received warrants to purchase up to an additional 15% of the common stock. *Gen. Motors*, 407 B.R. at 482–83.

1. *Id.* at 481.
2. *Id.* at 482.
3. *Id.*
4. *Id.*
5. *Id.* at 483–84.
6. *See id.* at 483.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

one need simply posit a sale in which the only consideration is an all-cash purchase price. Such a sale fixes the aggregate value of the bankruptcy estate that will then be separately and independently distributed to the debtor's creditors and owners, either under a subsequent liquidating plan of reorganization or through a conversion to a chapter 7 liquidation. Aggregate value maximization is, of course, a central concern of the chapter 11 process; its entire existence is premised upon an ability to produce more aggregate value (and, consequently, greater individual stakeholder recoveries) than through a chapter 7 liquidation or through a nonbankruptcy workout. Indeed, the vast literature of critiques and defenses of chapter 11 essentially debates how best to maximize aggregate estate value (and thus aggregate stakeholder recoveries).[1]

This is a particularly difficult problem because estate maximization does not perfectly correlate with maximizing *individual* stakeholder recoveries. Some individual stakeholders may well favor processes that do *not* maximize the aggregate value of the estate simply because they *do* maximize those individual stakeholders' ultimate recoveries. Conducting a sale through a § 363(b) motion rather than through a plan of reorganization disenfranchises individual creditors and owners on the value maximization question: Is this proposed sale of substantially all of the debtor's assets the best reasonably available means to maximize estate value? Whereas a chapter 11 plan of reorganization, through its class voting procedures, would put this question directly to individual stakeholders, the § 363(b) process relies more upon a "representative democracy" model (and indeed an extremely diluted one at that). In a § 363 sale process, creditors do not vote at all; instead, they are represented en masse by an official creditors' committee, which speaks for the collective interest of general unsecured creditors.[2] The court, having heard the committee's pitch, is then free to make its decision, and although the court typically takes the wishes of major stakeholder groups into account, it is formally unconstrained by their views.[3]

Chapter 11 control rights and practices (i.e., *who* ultimately controls the decision to propose a sale or a plan) will play a large role in determining which process will be employed in any given case. That chapter 11 dynamic has

1. For an introduction to this literature, see CHARLES J. TABB, BANKRUPTCY ANTHOLOGY ch. 15 (2002).

2. *See generally* Daniel J. Bussel, *Coalition-Building Through Bankruptcy Creditors' Committees*, 43 UCLA L. REV. 1547 (1996); Kenneth N. Klee & K. John Shaffer, *Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 44 S.C. L. REV. 995 (1993). Commonality of unsecured creditors' interests, though, seems to be on the decline due to changing capital structures, new financial instruments, and claims trading. *See generally* Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648 (2010).

3. Klee & Shaffer, *supra* note 66, at 1051–52.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

shifted perceptibly from a DIP-controlled[1] process (typically favoring plans) to a creditor/DIP–lender controlled process (typically favoring sales).[2] Of course, the legal threshold for permissibility of a preplan sale is also determinative, and evolution of that standard has seen a correlative shift from initial skepticism of preplan sales to the now-prevailing full embrace.[3] Clearing what is now a very low hurdle, therefore, was not really much of an issue in either *Chrysler* or *GM*.

The dominant approach to this issue is the Second Circuit's *Lionel* "good business reason" standard: "[T]here must be some articulated business justification, other than appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under section 363(b)."[4] "The rule we adopt requires that a judge determining a § 363(b) application expressly find from the evidence presented before him at the hearing a good business reason to grant such an application."[5]

Although the "good business reason" proffered in both *Chrysler* and *GM* was, at bottom, simply "appeasement of a major creditor"—the U.S. Treasury, which insisted on the expeditious sales as a condition of its financing—that creditor was also evidently the *only* available source of financing for the debtors' ongoing operations, as well as the *only* prospective "purchaser" of the debtor's assets.[6] The wearing of two hats (both major creditor and prospective purchaser) in most cases might cause us to question whether an immediate sale is serving anyone's interests (other than those of the creditor/purchaser),[7] but the stark reality of the auto cases was that there was little that could be done about it as a practical matter. The government insisted that it would not

1. "DIP" is the standard shorthand for the "debtor-in-possession," which is the prebankruptcy "debtor" continuing after the filing of a chapter 11 petition in the role of representative of the bankruptcy estate, equivalent to a trustee. 11 U.S.C. §§ 1101(1), 1107 (2006).

2. *See* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 777–88 (2002); Stephen J. Lubben, *The "New and Improved" Chapter 11*, 93 KY. L.J. 839, 848–56 (2005); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 923–26 (2003).

3. *See* TABB, *supra* note 10, § 11.13, at 1097.

4. Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1070 (2d Cir. 1983).

5. *Id.* at 1071.

6. *In re* General Motors Corp., 407 B.R. 463, 477, 480 (Bankr. S.D.N.Y. 2009).

7. Indeed, the most common criticism of *Chrysler* and *GM* is that the sale procedures were not designed to foster robust competitive bidding or otherwise maximize the sales prices. *See* Roe & Skeel, *supra* note 18, at 746–51; Barry E. Adler, *A Reassessment of Bankruptcy Reorganization After Chrysler and General Motors*, 18 AM. BANKR. INST. L. REV. 305, 307, 312 (2010); Douglas G. Baird, Car Trouble 13–14 (2010) (unpublished manuscript, on file with authors).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

continue to finance the debtors' operations if the sales were not approved, which would have forced an immediate liquidation in each case.[1]

In fact, Chrysler manufacturing did temporarily "cease operations in order to conserve resources" and "with a view towards ensuring that the facilities were prepared to resume normal production quickly after any sale, and that consumers were not impacted."[2] Bankruptcy Judge Gerber likewise recognized the overwhelming practical necessity of approving an expedited sale in *GM*,[3] stating that "[a]bsent prompt confirmation that the sale has been

1. *General Motors*, 407 B.R. at 491–92; *In re* Chrysler LLC, 405 B.R. 84, 96 (Bankr. S.D.N.Y. 2009). For an insightful game theory model of such posturing as between a DIP financer and the bankruptcy judge, see Baird, *supra* note 74, at 24–27.

2. *Chrysler*, 405 B.R. at 96.

3. The court quoted the *Chrysler* bankruptcy judge:

A debtor may sell substantially all of its assets as a going concern and later submit a plan of liquidation providing for the distribution of the proceeds of the sale. This strategy is employed, for example, when there is a need to preserve the going concern value because revenues are not sufficient to support the continued operation of the business and there are no viable sources for financing.

Gen. Motors, 407 B.R. at 491 (quoting *Chrysler*, 405 B.R. at 96). The court summarized, and agreed with, the government's position:

The U.S. Government understood the draconian consequences of the situation—one that affected not just GM, but also Chrysler, and to a lesser extent, Ford (the "Big Three"). And the failure of any of the Big Three (or worse, more than one of them) might well bring grievous ruin on the thousands of suppliers to the Big Three (many of whom have already filed their own bankruptcy cases, in this District, Delaware, Michigan and elsewhere); other businesses in the communities where the Big Three operate; dealers throughout the country; and the states and municipalities who looked to the Big Three, their suppliers and their employees for tax revenues. The U.S. Government's fear—a fear this Court shares, if GM cannot be saved as a going concern—was of a systemic failure throughout the domestic automotive industry and the significant harm to the overall U.S. economy that would result from the loss of hundreds of thousands of jobs and the sequential shutdown of hundreds of ancillary businesses if GM had to cease operations.

Id. at 477.

Absent prompt confirmation that the sale has been approved and that the transfer of the assets will be implemented, GM will have to liquidate. There are no realistic alternatives available. There are no merger partners, acquirers, or investors willing and able to acquire GM's business. Other than the U.S. Treasury and EDC, there are no lenders willing and able to finance GM's continued operations. Similarly, there are no lenders willing and able to finance GM in a prolonged chapter 11 case.

The continued availability of the financing provided by Treasury is expressly conditioned upon approval of this motion by July 10, and prompt closing of the 363 Transaction by August 15. Without such financing, GM faces immediate liquidation.

Id. at 484.

Even if funding were available for an extended bankruptcy case, many consumers would not consider purchasing a vehicle from a manufacturer whose future was uncertain and that was entangled in the bankruptcy process.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

approved and that the transfer of the assets will be implemented, GM will have to liquidate. There are no realistic alternatives available."[1] That outcome, in turn, would result in "a systemic failure throughout the domestic automotive industry and the significant harm to the overall U.S. economy that would result from the loss of hundreds of thousands of jobs and the sequential shutdown of hundreds of ancillary businesses if GM had to cease operations."[2] Chrysler, of course, was facing a similar predicament, and thus the Second Circuit also easily concluded that Bankruptcy Judge Gonzalez did not abuse his discretion by deciding that the immediate sale (on which the government insisted) best maximized the value of the Chrysler bankruptcy estate under the circumstances.[3]

One could speculate that the government was, in fact, bluffing, and would not have forced liquidation of either Chrysler or GM, even if approval of the § 363 sales was withheld.[4] Of course, the only way to know for sure whether the government was bluffing would be to call the government's bluff

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Thus the Court agrees that a lengthy chapter 11 case for the Debtors is not an option. It also agrees with the Debtors and the U.S. Government that it is not reasonable to expect that a reorganization plan could be confirmed in the next 60 days (*i.e.*, 90 days from the Filing Date).
The Auto Task Force talked to dozens of experts . . . . None of them felt that GM could survive a traditional chapter 11 process. . . . It became clear to the Auto Task Force that a bankruptcy with a traditional plan confirmation process would be so injurious to GM as to not allow for GM's viability going forward.
The Court accepts this testimony, and so finds. A 90 day plan confirmation process would be wholly unrealistic. In fact, the notion that a reorganization with a plan confirmation could be completed in 90 days in a case of this size and complexity is ludicrous, especially when one is already on notice of areas of likely controversy.
Id. at 485. The court concluded that "it is hard to imagine circumstances that could more strongly justify an immediate 363 sale." *Id.* at 491.

1. *Id.* at 484.

2. *Id.* at 477.

3. *In re* Chrysler LLC, 576 F.3d 108, 118–19 (2d Cir. 2009). The court elaborated:
Applying the *Lionel* factors, Bankruptcy Judge Gonzalez found good business reasons for the Sale. The linchpin of his analysis was that the only possible alternative to the Sale was an immediate liquidation that would yield far less for the estate—and for the objectors. . . .
The Sale would yield $2 billion. According to expert testimony—not refuted by the objectors—an immediate liquidation of Chrysler . . . would yield in the range of nothing to $800 million. . . . To preserve resources, Chrysler factories had been shuttered, and the business was hemorrhaging cash. According to the bankruptcy court, Chrysler was losing going concern value of nearly $100 million each day.
. . . With its revenues sinking, its factories dark, and its massive debts growing, Chrysler fit the paradigm of the melting ice cube. Going concern value was being reduced each passing day that it produced no cars, yet was obliged to pay rents, overhead, and salaries. Consistent with an underlying purpose of the Bankruptcy Code—maximizing the value of the bankrupt estate—it was no abuse of discretion to determine that the Sale prevented further, unnecessary losses.
Id.

4. *See, e.g.*, Roe & Skeel, *supra* note 18, at 749–51.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

by withholding approval of the sales. Given the enormity of what was at stake in these cases, though, one can hardly fault the bankruptcy judges for refusing to "play chicken" with the government.[1] Indeed, in the "representative democracy" world of § 363 sales in which the court (absent facial self-dealing, conflict of interest, or other disqualifying circumstance) largely defers to the business judgment of the major stakeholder (fiduciary) representatives (such as the DIP and official unsecured creditors' committee),[2] the *Chrysler* and *GM* courts had no cause whatsoever to second-guess the determination of *all* the major stakeholder representatives in both cases that (i) the only realistic alternative to an immediate sale in each case was liquidation, and (ii) liquidation would produce less aggregate value for each of the debtor's estates than the proposed sales.

B.*Sub Rosa* Plans of Reorganization: Distribution of Estate Value Through a § 363 Sale

The shift from "direct democracy" (plan process) to "representative democracy" (sale process) in determining how to best maximize the value of the debtor's estate is not all that surprising. Indeed, the elaborate procedural and substantive protections surrounding the plan confirmation process do not seem ideally suited to (or even primarily directed at) that particular decision. Rather,

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1. As Judge Gerber put it in *GM*:

[Dissenting bondholders suggested] that the *Court* should step in to tell everyone that a 363 sale was unacceptable. The premise underlying this contention was that the U.S. Government's July 10 deadline was just posturing, and that the Court should assume that the U.S. Government cares so much about GM's survival that the U.S. Government would never let GM die.

The Court declines to accept that premise and take that gamble. The problem is not that the U.S. Treasury would walk away from GM if this Court took an extra day or so to reach its decision. The problem is that if the 363 Transaction got off track, especially by the disapproval the [dissenting bondholders] seek[], the U.S. Government would see that there was no means of early exit for GM; that customer confidence would plummet; and that the U.S. Treasury would have to keep funding GM while bondholders (and, then, perhaps others) jousted to maximize their individual incremental recoveries. . . .

[Dissenting bondholders were] expecting this Court to play Russian Roulette . . . . So that the [dissenting bondholders] could throw GM into a plan negotiation process, the Court would have to gamble on the notion that the U.S. Government didn't mean it when it said that it would not keep funding GM. There is no reason why any fiduciary, or any court, would take that gamble. This is hardly the first time that this Court has seen creditors risk doomsday consequences to increase their incremental recoveries, and this Court—which is focused on preserving and maximizing value, allowing suppliers to survive, and helping employees keep their jobs—is not of a mind to jeopardize all of those goals.

Thus there is more than "good business reason" for the 363 Transaction here.

Gen. Motors, 407 B.R. at 492–93. Judge Gonzalez likewise declined a similar invitation in *Chrysler*, calling it "gambling on the possibility that the government was bluffing, and risking the potential for a lesser recovery in a resulting liquidation." *Chrysler*, 405 B.R. at 97 n.15.

2. *See supra* notes 66–70 and accompanying text.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

the principal object of the rules surrounding confirmation of a plan of reorganization is ensuring baseline protections with respect to the *distribution* of the value of the estate amongst the debtor's creditors and owners. Consequently, this is the realm in which *sub rosa* plan issues properly come into play.

Unfortunately, much of the case law on *sub rosa* plans fails to make clear exactly what constitutes a *sub rosa* plan and what is objectionable about a *sub rosa* plan. For example, it is common to simply state (unhelpfully) that "[t]he reason *sub rosa* plans are prohibited is based on a fear that a debtor-in-possession will enter into transactions that will, in effect, 'short circuit the requirements of [C]hapter 11 for confirmation of a reorganization plan.'"[1] Recognizing, though, that what we are seeking to preserve intact are the plan confirmation protections regarding *distribution* of the value of the debtor's estate sharpens the analytical edge of *sub rosa* plan doctrine.

Thus, the mere fact that our chapter 11 debtor (in our initial posited scenario) seeks to sell substantially all of its assets for cash-only under § 363 (rather than pursuant to a confirmed plan of reorganization) should not make that sale a *sub rosa* plan, because the cash-only sale itself does not direct any particular allocation or distribution of the cash proceeds generated by the sale—that is done by an entirely separate and distinct subsequent distribution process governed by applicable priority rules. As Judge Walsh stated in *Trans World Airlines (TWA)*:

It is true, of course, that TWA is converting a group of volatile assets into cash. It may also be true that the value generated is not enough for a dividend to certain groups of unsecured creditors. It does not follow, however, that the sale itself dictates the [distribution] terms of TWA's future chapter 11 plan. The value generated through the Court approved auction process reflects the market value of TWA's assets and the conversion of the assets into cash is "the contemplated result under § 363(b)."[2]

Conversely, then, and as Judge Gerber astutely recognized in *GM*, a non-plan § 363 sale "may be objectionable as a *sub rosa* plan if the sale itself seeks to allocate or dictate the distribution of sale proceeds among different classes of creditors."[3] Indeed, any chapter 11 practice that seeks to distribute estate value to creditors or owners outside of a confirmed plan of reorganization

1. Motorola, Inc. v. Official Comm. of Unsecured Creditors (*In re* Iridium Operating LLC), 478 F.3d 452, 466 (2d Cir. 2007) (quoting Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983)).
2. *In re* Trans World Airlines, Inc., No. 01-00056(PJW), 2001 WL 1820326, at *12 (Bankr. D. Del. Apr. 2, 2001) (quoting *Braniff*, 700 F.2d at 939–40).
3. *Gen. Motors*, 407 B.R. at 495.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

(e.g., critical vendor payments) is facially suspect if it will, in effect, "set aside the Code's rules about priority and distribution."[1]

So let us now analyze both the *Chrysler* and *GM* sales using this more precise and useful distribution-by-sale understanding of the *sub rosa* plan prohibition. Doing so reveals that the real danger of § 363 sales is unchecked (and apparently unknowing) contraventions of core norms of distributive entitlements among stakeholders. This danger irrefutably came to pass in *GM*, but not in *Chrysler*. Let us start with *Chrysler*.

1.The Absolute-Priority Red Herring in *Chrysler*

The *sub rosa* plan objection that has been most visible is that of some dissident secured creditors in *Chrysler*—Indiana Pension Funds "argue[d] that the Sale [was] a *sub rosa* plan chiefly because it [gave] value to unsecured creditors (i.e., in the form of the ownership interest in New Chrysler provided to the union benefit funds) without paying off secured debt in full."[2] This was, then, essentially an absolute-priority argument, which is one of the most central, fundamental distribution-value protections of a chapter 11 plan: An objecting class of creditors that is not paid in full can insist that "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property."[3] There were two fatal flaws in this absolute-priority argument, though: (1) the Indiana Pensioners' relevant class of secured claims consented to the *Chrysler* sale; and (2) the sale of a secured creditor's collateral, with liens attaching to the proceeds, does not vitiate the secured creditor's absolute-priority rights in that collateral; rather, just the opposite is true—the sale vindicates the creditor's absolute-priority rights.

a. Absolute Priority Protects Only Dissenting Classes

Absolute-priority protections, captured in the so-called "cram-down" rules of Code § 1129(b)—implementing "the condition that a plan be fair and equitable with respect *to a class*"[4]—only apply (as the preceding phrase indicates) to a "class of claims" that "has not accepted[] the plan;"[5] in other words, *individual* dissenting creditors have no absolute-priority rights in chapter 11 if their *class* accepts the plan. The only distribution-value protection accorded an *individual* dissenting creditor is "best interests" protection, ensuring that any

1. *In re* Kmart Corp., 359 F.3d 866, 871 (7th Cir. 2004).
2. *In re* Chrysler LLC, 576 F.3d 108, 118 (2d Cir. 2009).
3. 11 U.S.C. § 1129(b)(2)(B)(ii) (2006).
4. *Id.* § 1129(b)(2) (emphasis added).
5. *Id.* § 1129(b)(1).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

individual dissenting creditor "will receive or retain under the plan on account of such [creditor's] claim . . . property of a value . . . that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7."[1] Through class acceptance of a proposed plan, creditors can consent to whatever distribution of reorganization surplus (value in excess of that which creditors would receive in an immediate liquidation) they consider appropriate, and this class consent binds individual dissenting class members.

The dissenting Indiana Pension Funds were part of Chrysler's senior secured lending consortium, holding only a very small percentage of Chrysler's senior secured debt, and senior secured lenders holding 92.5% of that debt had consented to the proposed Fiat sale.[2] In a plan context, the claims of all of these senior secured lenders (having the same rank against the same collateral) would almost certainly comprise one class of secured claims,[3] and, given their overwhelming consent to the proposed Fiat sale, one can safely presume that this class of secured claims would vote to accept if the Fiat sale were proposed through a plan of reorganization.[4]

If we can safely assume that the class would give its consent, then the Indiana Pension Funds' only distribution-value right at stake was best-interests protection. Judge Gonzalez specifically found "that the $2 billion New Chrysler is paying for the Debtors' assets exceeds the value that the First–Lien Lenders could recover in an immediate liquidation."[5] It appears, therefore, that the Fiat sale under § 363 did not deprive the Indiana Pension Funds of any applicable distribution-value protections that the chapter 11 plan process would afford.

b. Sale of a Secured Creditor's Collateral Does Not Violate Absolute Priority

Even if we could presume, counterfactually, that the Indiana Pension Funds' class would not have accepted a plan proposing the Fiat sale transaction, the other difficulty with the Indiana Pension Funds' absolute-priority objection is this: a class of secured creditors simply cannot insist that "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property."[6] This is the absolute-priority standard applicable only to a dissenting class of *unsecured* creditors. For an objecting class of *secured* creditors, a plan is "fair and equitable" (and thus fully respects those secured creditors' absolute priority

1. *Id.* § 1129(a)(7)(A)(ii).
2. *In re* Chrysler LLC, 405 B.R. 84, 93, 102 (Bankr. S.D.N.Y 2009).
3. *See* TABB, *supra* note 10, § 11.17, at 1108.
4. *See* 11 U.S.C. § 1126(c).
5. *Chrysler*, 405 B.R. at 97.
6. 11 U.S.C. § 1129(b)(2)(B)(ii).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

rights) if the plan provides "for the sale, subject to section 363(k) . . . , of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale."[1] As long as a proposed § 363(b) sale replicates this requirement, a secured creditor has no basis to contend that the § 363 sale is undermining that creditor's absolute-priority rights in the collateral.

Whenever there is a proposed sale of a *secured* creditor's collateral, therefore, whether through a plan of reorganization or a § 363 sale, the secured creditor's principal distribution-value protection lies in the secured creditor's right under § 363(k) to "bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property."[2] A secured creditor's right to credit bid on any sale of its collateral is a particularly powerful protection for an undersecured creditor with first-priority liens on substantially all of the debtor's assets, which was the case in *Chrysler* with respect to the senior secured lenders, who were owed $6.9 billion. Indeed, the right to credit bid protects such an undersecured creditor's interest in both the liquidation value and any reorganization surplus implicit in its collateral.

For example, if Chrysler's senior secured lenders thought that Judge Gonzalez's liquidation-value finding was incorrect and that the liquidation value of Chrysler's assets exceeded $2 billion, they could have credit bid up to $6.9 billion (without any cash outlay) to acquire Chrysler's assets, and then liquidated those assets. Moreover, if they thought they could realize an even greater going-concern recovery than the $2 billion they would get from the Fiat sale (by, for example, striking an even harder bargain with UAW workers and retirees), they could have acquired Chrysler's assets in the same manner and then operated (or sold) Chrysler as a going concern. Those senior secured lenders, however, opted instead to take the $2 billion offered by the Fiat sale. As Judge Gonzalez noted, the senior secured lenders "could have chosen to credit bid instead of agreeing to take cash."[3] Given this fact, there is little basis on which to conclude that the § 363 sale violated the senior secured lenders' absolute-priority rights or any other distribution-value protection that chapter 11 affords secured creditors.

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1. *Id.* § 1129(b)(2)(A)(ii).
2. *Id.* § 363(k). Amazingly, a secured creditor's right to credit bid in any sale of its collateral pursuant to a plan of reorganization has been questioned recently. *See In re* Phila. Newspapers, LLC, 599 F.3d 298, 301 (3d Cir. 2010); Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 245–47 (5th Cir. 2009). *See generally* Brubaker, *Cramdown*, *supra* note 17, at 1, 4–15. Affording a secured creditor the right to credit bid in a plan sale of its collateral, though, unquestionably protects that secured creditor's absolute-priority rights.
3. *Chrysler*, 405 B.R. at 98.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

c. The Secured Creditors' Consent to the Sale

The Indiana Pension Funds attempted to invalidate the senior secured lenders' consent to the Fiat sale, which was proffered through their designated collateral trustee at the direction of lenders holding a majority of the debt, and which also bound the Indiana Pension Funds pursuant to the senior secured lenders' nonbankruptcy agreements regarding enforcement of the senior secured lenders' liens. The Indiana Pension Funds contended that those lenders who had received Troubled Asset Relief Program (TARP) funding from the U.S. Treasury were improperly influenced by the U.S. government to consent to the sale.[1] Although this possibility (and its impact upon, for example, the senior secured lenders' willingness to press their rights, such as the right to credit bid) is somewhat disconcerting, the bankruptcy court concluded that there was insufficient evidence of this presented to justify blocking the proposed Fiat sale.[2]

Of course, a § 363 motion is not well-suited for entertaining any breach or other claims that the Indiana Pension Funds might have had against the other senior secured lenders or the collateral trustee. Additionally, both the bankruptcy court and the Second Circuit indicated that any viable claim the Indiana Pension Funds might possess could be pursued in a separate damages action in an appropriate forum.[3] Were the Fiat sale being proposed through a plan of reorganization, rather than a § 363 motion, the Indiana Pension Funds' allegations might have been asserted via an attempt to "designate" (i.e., disqualify) TARP-recipient lenders' plan votes as "not in good faith" under § 1126(e) of the Bankruptcy Code.[4] Plan confirmation proceedings, though, are also not well-suited for entertaining whatever breach claims the Indiana Pension Funds might have, and depriving the Indiana Pension Funds of an uncertain vote-designation process (with an uncertain, indirect impact upon the Indiana Funds' distribution-value protections) seems like an insufficient basis, in and of itself, to characterize the § 363 sale as a *sub rosa* plan.

Nothing about the fact that the *Chrysler* deal was effectuated by a *sale* rather than through a *plan* undermined the court's oversight of the legitimacy of

1. *Id.* at 103.
2. The court noted:

> The Indiana Funds seem to be asking that . . . the Court should nullify the consent given because it was brought about by undue pressure by the U.S. government on the TARP-recipient lenders, who voted to give consent to the transaction before the Court.
>
> However, the suggestion that the TARP-recipient lenders have been pressured to the point that they would breach their fiduciary duty and capitulate to the settlements presented is without any evidentiary support. It is mere speculation and without merit.

Id. at 103–04.
3. *See In re* Chrysler LLC, 576 F.3d 108, 122–23 (2d Cir. 2009); *Chrysler*, 405 B.R. at 103.
4. 11 U.S.C. § 1126(e).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

the banks' consent. Indeed, there is no reason to believe that Judge Gonzalez would have reached a different conclusion if the independence issue had been litigated under § 1126(e) instead of § 363. One might believe, as Roe and Skeel do,[1] that Judge Gonzalez got the independence question wrong, but that error (if there was one) did not turn on the fact that a sale rather than a plan process was used. Under either process, if the TARP-recipient lenders or the collateral trustee breached obligations owed to the Indiana Funds through their consent to the Fiat sale, it seems perfectly appropriate to relegate the Indiana Funds to a damages remedy, in the absence of an evidentiary showing that would justify the equivalent of a TRO or preliminary injunction, a showing that evidently was not made in *Chrysler*.

2. Creditor Inequality Implicit in a Purchaser's Assumption of Liabilities

As discussed above, a cash-only § 363 sale of even substantially all of a debtor's assets does not properly implicate *sub rosa* plan concerns, but now let us posit a sale of substantially all of the debtor's assets to a third-party purchaser for consideration comprised of cash *plus assumption of certain designated liabilities* of the debtor. Indeed, that is essentially how the purchase price was structured in the *Chrysler* case, although the assumption of Chrysler's retiree VEBA debt was assumption of a modified VEBA debt (part promissory note, part ownership participation in New Chrysler[2]). Of course, to the extent the debt assumption is in conjunction with an assigned executory contract, such a debt assumption and the corresponding payment-in-full of the contract counterparty is expressly contemplated and sanctioned by § 365 of the Bankruptcy Code[3] and, therefore, does not transform the § 363 sale into a *sub rosa* plan. Presumably, though, the designated assumed debts in *Chrysler* (and also *GM*) went beyond the scope of the assumption and assignment of executory contracts expressly authorized by § 365.

To the extent a § 363 purchaser assumes the debtor's prepetition general unsecured debts (such as trade debts or Chrysler's retiree VEBA debt) as part of the designated "purchase price" for the debtor's assets, at first blush it seems as if "the sale itself seeks to allocate or dictate the distribution of sale proceeds among different classes of creditors"[4] and thus does implicate *sub rosa* plan concerns that warrant further scrutiny.[5] As Judge Walsh acknowledged in

1. Roe & Skeel, *supra* note 18, at 743–46.
2. *Chrysler*, 405 B.R. at 92.
3. 11 U.S.C. § 365.
4. *In re* Gen. Motors Corp., 407 B.R. 463, 495 (Bankr. S.D.N.Y. 2009).
5. Several commentators have condemned the contractual debt assumption in *Chrysler* and *GM*. *See* Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR. L.J.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

TWA, when a § 363 purchaser assumes specified unsecured debts, a "disparate treatment of creditors occurs as a consequence of the sale transaction itself."[1]

The distribution-value protection at stake here is unsecured creditor equality, which is vindicated in chapter 11's distribution scheme through both the classification and treatment provisions of § 1122(a) and § 1123(a)(4) and the "*unfair discrimination*" standard of § 1129(b)(1).[2] Those unsecured creditors whose claims are not being assumed, even if they will receive at least as much as they would in a liquidation, may legitimately object that the debtor's reorganization surplus is being distributed inequitably, without subjecting that distribution to the class voting and approval process that chapter 11 contemplates for allocating reorganization surplus among the debtor's various classes of creditors.

a. Two Scenarios for a Purchaser's Assumption of Liabilities

On closer examination, however, this issue is not without complication. Payments made by the purchaser on assumed debts arguably do not represent value that would ever be available to the debtor's estate for distribution according to applicable priority rules if it is the *purchaser* that designated the debts to be assumed. Let us explore this possibility by considering two opposite-extreme scenarios with respect to assumed debts.

Scenario One

Purchaser is willing to pay $100 for Debtor's business, and Purchaser independently determines that full payment of certain unsecured creditors (owed $9) is important to its ongoing relationship with those creditors and its ability to operate the purchased business profitably on a going-forward basis. Purchaser, thus, offers to pay $91 cash for Debtor's business, *plus* assumption of the designated $9 of Debtor's unsecured debt. If Purchaser is unable contractually to assume the designated debts as part of the agreement for purchase of Debtor's business, Purchaser *will still pay only $91* cash for Debtor's business, and then will simply pay the $9 of unsecured debt after closing on the purchase.

663, 731 (2009); Roe & Skeel, *supra* note 18, at 751–60; Adler, *supra* note 74, at 307, 308–10, 313–14, 316–18.

1. *In re* Trans World Airlines, Inc., No. 01-00056(PJW), 2001 WL 1820326, at *11 (Bankr. D. Del. Apr. 2, 2001). Whereas the implication of this fact for Judge Walsh was that the § 363 sale is *not* a *sub rosa* plan, if distribution-by-sale is the sine qua non of a *sub rosa* plan, a § 363 purchaser's assumption of the debtor's unsecured prepetition debts obviously is cause for concern.

2. 11 U.S.C. §§ 1122(a), 1123(a)(4), 1129(b)(1). *See generally* Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L.J. 227 (1998).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

Scenario Two

Purchaser is willing to pay $100 for Debtor's business, and Purchaser independently determines that it can procure all necessary operating supplies, labor, etc., and profitably operate the purchased business on a going-forward basis without assuring full payment to any of Debtor's unsecured creditors. It is important, however, to Debtor's management (or some other influential constituency, such as powerful creditors) that certain unsecured creditors be paid in full. As part of the sale negotiations, therefore, one of the deal points is assumption of $9 of designated unsecured debts, to which Purchaser is more than happy to agree (particularly if there is more than one prospective purchaser looming about). With the $9 of assumed unsecured debt, though, Purchaser is only willing to pay $91 cash for Debtor's business, given that Purchaser's total willing purchase price is $100. If Purchaser did not contractually assume the designated debts as part of the agreement for purchase of Debtor's business, Purchaser *would pay $100* cash for Debtor's business, and would not pay any of Debtor's unsecured debt after closing on the purchase.

In Scenario Two, the debt assumption is precisely the kind of hand-picking of certain favored unsecured creditors for preferential treatment that is the antipathy of the Bankruptcy Code's distribution rules. In Scenario One, though, the debt assumption is not value that is, in any sense, being unfairly taken from or diverted away from the debtor's other unsecured creditors, as it would not increase the consideration paid for Debtor's business even in the absence of the debt assumption. The difficulty, of course, is determining in any given case whether a debt assumption is Scenario One or Scenario Two.[1] Indeed, the bankruptcy courts have struggled with precisely this same problem of distinguishing Scenario One from Scenario Two, ex post, in the context of prebankruptcy sales of a debtor's business that involved an assumption of unsecured debts by the purchaser as part of the designated "purchase price," with the debt assumption challenged as an avoidable preferential transfer in the debtor's subsequent bankruptcy filing.[2]

The mere fact that a purchaser has designated a portion of the purchase price to be paid through an assumption of "critical" creditors' debts tells us

1. This dilemma is extremely similar to the "critical vendor conundrum" posed by requests to fully pay unsecured prepetition debts owing to a chapter 11 debtor's "critical" vendors, outside of a plan of reorganization, to ensure that those vendors will continue to sell to the debtor. See CHARLES J. TABB & RALPH BRUBAKER, BANKRUPTCY LAW: PRINCIPLES, POLICIES, AND PRACTICE 685–90 (3d ed. 2010); Charles Jordan Tabb, Emergency Preferential Orders in Bankruptcy Reorganizations, 65 AM. BANKR. L.J. 75, 76–79 (1991); Ralph Brubaker, Reassessing Our Commitment to Unsecured Creditor Equality: Critical Vendor Orders After Kmart (Part I), BANKR. L. LETTER, May 2004, at 1.

2. See Ralph Brubaker, Of Give-Ups, Critical Vendors, Diminution of the Estate, and Preference Policy, BANKR. L. LETTER, Sept. 2006, at 1, 1–5.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

nothing about whether it is a Scenario One or Scenario Two debt assumption.[1] Indeed, pressure on the purchaser to prefer certain creditors and insist on debt assumption may come directly from the creditors themselves; in that case, the purchaser may have very little reason to resist the pressure. Critical or not critical is not a dichotomous categorization; rather, it is more of a continuum, and there is no profit to the prospective new purchaser of a business in testing how critical a particular vendor is if that risks either (i) shutting off an otherwise reliable source of supplies, labor, etc., and/or (ii) substantial opposition to the § 363 sale. Thus, even in a Scenario Two debt assumption, we could expect Purchaser, when called to testify at the § 363 hearing, to confidently state:

It is very important to the continuity of the business's operations that the designated assumed debts be paid in full, and that's why we have designated a portion of the purchase price to be paid by debt assumption. Furthermore, it's extremely unlikely that we would go forward with this acquisition without the ability to fully pay debts owing important creditors.

Indeed, the relative impenetrability of this inquiry and "intolerably high risk of collusion" has led most courts, in the preference context, to adopt "a bright line rule" pursuant to which "[p]reference liability will be strictly imposed on creditors who receive preferential treatment as part of a purchase transaction,"[2] even "when the third party [purchaser], rather than the debtor, specifies which creditor[s] will receive the funds."[3]

In the § 363 sale context, though, the operative legal rule itself will affect the dynamic at work in "critical" creditors' demands for full payment. The effectiveness (and likelihood) of purportedly "critical" creditors' demands for payment of their prepetition claims depends, in part, on how much resistance they can expect to encounter from the purchaser, and the amount of resistance the purchaser can, in turn, assert in response to such a demand is very much a function of the legal permissibility of the debt assumption. If the debt assumption will be rubber-stamped by the bankruptcy court as a matter of course in approving a § 363 sale, then more and more creditors will have sufficient leverage to demand and receive designation for debt assumption and, therefore, will find it in their interest to make the demand.

If debt assumption simply cannot be part of the sale agreement approved by the bankruptcy court, though, there is little reason for a creditor to

1. Professor Lubben evidently believes that a purchaser's contractual assumption of liabilities is unproblematic "if the purchaser did not underpay for the assets." Lubben, supra note 4, at 545. Even if we can all agree, though, that $100 is a fair price for Debtor's assets, that also tells us absolutely nothing about whether Purchaser's debt assumption is Scenario One or Scenario Two.

2. Feltman v. Bd. of County Comm'rs (In re S.E.L. Maduro (Fla.), Inc.), 205 B.R. 987, 993 (Bankr. S.D. Fla. 1997).

3. Warsco v. Preferred Technical Group, 258 F.3d 557, 565 (7th Cir. 2001).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

even make the demand. Moreover, both the debtor's and the purchaser's counsel could then credibly respond to any demand made that it is impermissible for the bankruptcy court to approve any debt assumption as part of the § 363 sale. Significantly, though, this would *not* prevent the purchaser, after closing on the sale, from simply paying debts owing any creditors that the purchaser wants paid. Indeed, this seems to be the only fool-proof way of ensuring that purchaser debt repayments are restricted to Scenario One: a bright-line rule prohibiting any court-approved assumption of general unsecured debt as part of a § 363 sale.

b. Was the *Chrysler* Debt Assumption a Scenario One?

Judge Gonzalez concluded that the assumption of unsecured debt in the *Chrysler* sale was akin to Scenario One depicted above:

New Chrysler has determined that, to effectively carry on its business, it should take over certain other of the Debtors' obligations [over and above those associated with assumed executory contracts]. Any such assumption of liability reflects the purchaser's business judgment, the effect of which does not constitute a *sub rosa* plan because the obligation is negotiated directly with the counterparty. Thus, any of the obligations under those agreements are satisfied by New Chrysler and do not constitute a distribution of proceeds from the Debtors' estates.[1]

As a general matter, we should be extremely skeptical of such a claim, as it will typically be purely speculative and essentially non-verifiable; however, in *Chrysler* there was a more objective verification of this claim. Chrysler's senior secured lenders, with first-priority liens on substantially all assets, were vastly undersecured, yet they consented to the Fiat sale and the $2 billion cash it would give them. If there was more money to be had from sale of their collateral, they had every incentive to exert their rights (including the right to credit bid) to the fullest in order to squeeze every last dime out of those assets. Those undersecured lenders' willingness to take the $2 billion when they were owed much more gives us an objective validation of the claim that the entirety of the debt assumption in *Chrysler* was incremental value that the government was willing to pay *only* in the form of debt assumption. As Judge Gonzalez put it, "there is no attempt to allocate the sale proceeds away from the First-Lien Lenders."[2] "Not one penny of value of the Debtors' assets is going to anyone other than the First-Lien Lenders."[3]

The ultimate conclusion in *Chrysler*, therefore, that the § 363 sale of substantially all of Chrysler's assets for $2 billion in cash was *not* a *sub rosa* plan

1. *In re* Chrysler LLC, 405 B.R. 84, 99 n.18 (Bankr. S.D.N.Y. 2009).
2. *Id.* at 98.
3. *Id.* at 97.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

of reorganization, seems fundamentally sound. The sale itself did not dictate distribution of sale proceeds in a manner that set aside the Code's rules about priority and distribution, which is, we submit, the critical question to ask. Furthermore, the dynamics of the *Chrysler* sale were such as to give considerable comfort as to the verifiability of that central fact, which is almost equally as important. The *GM* "sale," though, was a horse of a different color, on both counts.

3. *General Motors*: Ritualistic Self-Sale = "Reorganization"

Unlike the *Chrysler* sale, the *GM* sale was not a cash sale. Through a credit bid of secured debt, substantially all of GM's assets were transferred to a newly formed acquisition entity whose new capital structure had already been divvied up amongst GM's creditors, with a much larger allocation of New GM stock and warrants to UAW retirees than to GM's other unsecured creditors.[1] One could hardly imagine a starker example of a transaction that, regardless of its nominal form, is a quintessential "reorganization." Indeed, "[t]he key conceptual difference between a reorganization and a liquidation [by sale] is that in a reorganization the firm's assets . . . are sold to the creditors themselves rather than to third parties," so "[r]eorganization proceedings . . . are basically a method by which the sale of a firm as a going concern may be made to the claimants themselves."[2] Yet, *GM* effected this significant reorganization without even pretending to comply with any of the substantive or procedural rules that govern reorganizations, and in doing so deprived stakeholders in the firm of fundamental normative entitlements.

a. The "Sale" in Equity Receivership "Reorganizations"

To recognize the *GM* "sale" as the functional equivalent of a "reorganization," one need only revisit the historical origins of chapter 11's statutory provisions for judicial confirmation of a "plan of reorganization"—equitable receivership proceedings of insolvent railroads in the late 1800s.

Using old equitable forms which were designed to convert the properties of an insolvent debtor into cash for distribution among its creditors, [the federal courts] evolved a proceeding which achieved the opposite results of preserving the properties intact and of readjusting the debts of the insolvent debtor. The form of the procedure, briefly, was . . . a judicial sale of that property to the creditors free of the old debts; and its conveyance by the creditors to a new company formed for the purpose of carrying on the enterprise.[3]

Through the equitable receivership, "the creditors of the insolvent business debtor could themselves act as the buyers of the business—which

1. *See* Warburton, *supra* note 19, at 537–39; *supra* note 58 and accompanying text.
2. THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 211 (1986).
3. Thomas K. Finletter, The Law of Bankruptcy Reorganization 1 (1939).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

would be kept as a going concern, if that made sense—using not cash as the means of payment, but their creditor claims."[1] Indeed, because the mortgage bond debts of the railroads, in and of themselves, were typically vast in amount, the mortgage "[b]ondholders would initiate equity receiverships with the goal of a judicial sale of the road pursuant to the bondholders' mortgage."[2] Because the mortgagees "could bid the face value of the securities as a substitute for cash, no one else bothered to bid at the auction."[3]

A newly formed corporation would be the ultimate transferee of the purchased assets, and the capital structure of this new entity would be allocated amongst the debtor's creditors and owners pursuant to what was called the "plan of reorganization."[4] Equity receiverships, therefore, effectuated an internal boot-strap "reorganization," as distinguished from "a true sale to outsiders for cash,"[5] "through a plan of reorganization and a carefully orchestrated foreclosure of the railroad's assets."[6] Through the "ritual of the self-sale,"[7] the "creditors could, in effect, initiate a transformation of their debt holdings into stock, or into some mixture of new debt and stock."[8]

Of course, the hitch in this elaborate and stylized "sale" of the company to the debtor's creditors themselves, was attempting to ensure that creditors could "at the same time exercise their contractual rights of priority among themselves and against the residual claimants (the old shareholders) in a way that was just as definitive as a real liquidation sale to an outside buyer."[9] Thus came an elaborate "fair and equitable" jurisprudence regulating the allocation of interests in the new "purchasing" entity in order to address creditors' relative priority rights. This "fair and equitable" jurisprudence was the common-law precursor to the statutory plan confirmation requirements now codified in chapter 11, and it provides the underpinnings for protection of the entitlements of all stakeholders in a "reorganizing" firm.[10]

b. Everything Old Is New Again

The *GM* "sale" dictated distributions among GM creditors in precisely the same manner as did equitable receivership "sales." The non-cash § 363 sale

1. Robert C. Clark, *The Interdisciplinary Study of Legal Evolution*, 90 Yale L.J. 1238, 1252 (1981).
2. Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 76 (1991).
3. David A. Skeel, Jr., Debt's Dominion: A History of Bankruptcy Law in America 59 (2001).
4. *See* Finletter, *supra* note 122, at 3–5; Skeel, *supra* note 125, at 59.
5. Clark, *supra* note 123, at 1252.
6. Markell, *supra* note 124, at 75.
7. Clark, *supra* note 123, at 1253.
8. *Id.* at 1252.
9. *Id.*
10. *See* Markell, *supra* note 124, at 84–90.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

from Old GM to New GM not only resurrects the "ritual of the self-sale" (with uncanny similitude), but also invests the ritualistic self-sale with a newfound freedom and potency. If a *GM*-style § 363 sale is not a *sub rosa* plan of reorganization, not only is it freed from adherence to Chapter 11's distributional strictures, the § 363 sale-plan (or is it a plan-sale?) also evidently need not comply with the "fair and equitable" requisites to a valid common-law free-and-clear foreclosure sale. The "purchaser" is evidently entirely free to allocate its debt and ownership interests to and among the debtor's creditors and owners in whatever manner the "purchaser" wishes because, in the words of Judge Gerber in *GM*, "the allocation of value by the purchaser d[oes] not affect the *debtor's* interest."[1] Judge Gerber also quoted Judge Gonzalez's decision in the *Chrysler* case: "'*The allocation of ownership interests in the new enterprise is irrelevant to the estates' economic interests.*'"[2] The court elaborated, highlighting (evidently without realizing it) precisely why the legacy of *GM* is so problematic:

Nor can the Court accept various objectors' contention that there here is a *sub rosa* plan. Arrangements that will be made by the Purchaser do not affect the distribution of the *Debtor's* property, and will address wholly different needs and concerns—arrangements that the Purchaser needs to create a new GM that will be lean and healthy enough to survive.[3]

The court further stated that "in negotiating with groups essential to its viability (such as its workforce) the purchaser was free to provide ownership interests in the new entity as it saw fit" and that "the purchaser's allocation of value in its own enterprise did not elevate its measures into a *sub rosa* plan."[4]

The fundamental and profoundly disturbing problem with this notion is that it is precisely the same argument that was proffered during the development of "fair and equitable" jurisprudence a century ago, in an attempt to give value in the reorganized entity (nominal "purchaser") to the debtor's shareholders (while squeezing out unsecured creditors) in order to retain shareholders' supposed expertise in running the railroad. The Supreme Court, though, in a series of foundational cases, repeatedly rejected this argument.[5] The supposed dichotomy between the value of the "purchaser" and the interests of the debtor's estate is a manifestly false one. The Court recognized and gave effect to the obvious equivalence between (1) the value of the debtor's estate and (2)

1. *In re* Gen. Motors Corp., 407 B.R. 463, 497 (Bankr. S.D.N.Y. 2009).
2. *Id.* (quoting *In re* Chrysler LLC, 405 B.R. 84, 99 (Bankr. S.D.N.Y. 2009)).
3. *Id.* at 474–75.
4. *Id.* at 497. Professor Lubben expresses a similar sentiment. Lubben, *supra* note 4, at 545–46.
5. *See* N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 505 (1913); Louisville Trust Co. v. Louisville, New Albany & Chi. Ry. Co., 174 U.S. 674, 684 (1899); R.R. Co. v. Howard, 74 U.S. (7 Wall.) 392, 409–13 (1868). *See generally* Ralph Brubaker, *Inter-Class Give-Ups in a Chapter 11 Plan of Reorganization: Remembering the Origins of the Absolute Priority Rule*, BANKR. L. LETTER, June 2005, at 1.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

the value of the new entity created for the self-sale, in one of the most important passages in the history of bankruptcy reorganization law:

If the value of the road justified the issuance of stock [by the purchaser] in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid.[1]

Consequently, the "purchaser," acting under the guise of a "sale" of the debtor's property to it, was *not* free to dole out interests in the new "purchasing" entity to the debtor's creditors and shareholders in whatever manner the "purchaser" wanted:

It is one thing for a [mortgage] bondholder who has acquired absolute title by foreclosure to mortgaged property to thereafter give of his interest to others, and an entirely different thing whether such [mortgage] bondholder, . . . to secure a waiver of all objections on the part of the stockholder and consummate speedily the foreclosure, may proffer to him an interest in the property after the foreclosure. The former may be beyond the power of the courts to inquire into or condemn. The latter is something which on the face of it deserves the condemnation of every court, and should never be aided by any decree or order thereof. It involves an offer, a temptation, . . . the purchase price thereof to be paid, not by the mortgagee, but in fact by the unsecured creditor.[2]

The only difference between the equity receivership cases espousing these principles and *GM* is that those cases primarily "dealt with the precedence to be accorded creditors over stockholders in reorganization plans"[3]—what Professor and now-Judge Markell has called "*vertical* equity,"[4] now codified in the Code's "fair and equitable" standard of absolute priority.[5] *GM*, by contrast, involved claims of inequitable disparate treatment as between GM's unsecured creditors, principally because of the generous stake in New GM provided for UAW retiree benefit claims.[6] Equity receivership jurisprudence, though, evidenced a similar fairness concern for this *horizontal* equity as between creditors of the same priority rank,[7] now codified in the Code's equality of treatment provisions and the "unfair discrimination" standard.[8]

1. *Boyd*, 228 U.S. at 508.
2. *Louisville Trust*, 174 U.S. at 688.
3. Case v. L.A. Lumber Prods. Co., 308 U.S. 106, 115–16 (1939).
4. *See* Markell, *supra* note 111, at 231 (emphasis added).
5. 11 U.S.C. § 1129(b)(2) (2006).
6. *See In re* Gen. Motors Corp., 407 B.R. 463, 474, 482 (Bankr. S.D.N.Y. 2009).
7. *See* Markell, *supra* note 111, at 228–39.
8. 11 U.S.C. §§ 1122(a), 1123(a)(4), 1129(b)(1).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

To be sure, "unfair discrimination" is not an absolute standard, and it may be permissible to discriminate between classes of unsecured creditors "on the basis of the necessity of one class—and the nonnecessity of the other—to reorganization."[1] Markell provides the following example:

If, for example, the good will of a key union is necessary for the profitability of the reorganized debtor, and that necessity is proved by the plan proponent, then it is not unfair to return to that union more than its aliquot share of reorganization value since its efforts were responsible for the increase in that value.[2]

Indeed, this was precisely the proffered justification for the disparate treatment of UAW retiree benefit claims in *GM*: "[T]he Purchaser needs a properly motivated workforce to enable New GM to succeed, requiring it to enter into satisfactory agreements with the UAW—which includes arrangements satisfactory to the UAW for UAW retirees."[3] Moreover, the solicitous provisions of § 1114 and § 1129(a)(13) of the Bankruptcy Code[4] might also justify some measure of disparate treatment of retiree benefit claims.

The point, therefore, is not that there *was* unjustified "unfair discrimination" in favor of UAW retiree benefit claims in *GM*; the point is that, through the reorganization-by-sale sleight-of-hand, the disparate treatment the UAW retiree benefit claims indisputably received was *immunized from any scrutiny whatsoever* as to whether its value was commensurate with the UAW's contribution to the value of New GM.[5] As Markell notes, even if discrimination is necessary to reorganize, the dissenting class is entitled to at least some proof

1. Markell, *supra* note 111, at 260.

2. *Id.* at 261.

3.*Gen. Motors*, 407 B.R. at 512.

4. 11 U.S.C. §§ 1114, 1129(a)(13).

The primary thrust of § 1114 is to prevent a chapter 11 debtor in possession (or trustee) from unilaterally terminating or modifying insurance benefits for retired employees . . . . Thus, the heart of the section is subsection (e), which provides that the debtor in possession "shall timely pay and shall not modify any retiree benefits. . . . Section 1129(a)(13) complements § 1114(e) by requiring a confirmed plan to provide for continued payment of retiree benefits.

A permanent modification in retiree benefits may only be obtained if the bankruptcy court so orders, or if the authorized representative of the retirees agrees to the changes.

TABB, *supra* note 10, § 8.13, at 843 (citations omitted).

5.Professor Lubben actually acknowledges the possibility of unfair discrimination in the treatment of the UAW retiree benefit claims in *GM*, but inexplicably dismisses its significance by noting that "in the Second Circuit, separate classification and discrimination in favor of workers whose ability to strike could destroy the reorganization *may* constitute 'fair' discrimination," and "[w]hether the unsecured creditors would have rejected a hypothetical GM plan *is unclear*." Lubben, *supra* note 4, at 543 (emphasis added). That, of course, is precisely our point, and seizing upon the uncertainty regarding whether there was or was not impermissible unfair discrimination to justify simply foregoing the inquiry entirely (in the interest of nothing more than expedient approval of the § 363 sale, apparently) is precisely the problem with *GM*.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

that the value represented by the participation of the favored class in the reorganization is equivalent to the disparity in treatment. . . . A showing of the value of the participation is necessary to distinguish a situation of genuine need for discrimination from a ruse designed to channel reorganization value to friends.[1]

If it is true, though, that "*[t]he allocation of ownership interests in the new enterprise is irrelevant to the estates' economic interests*,"[2] then *anything goes*. There are no limits; the § 363 sale assumes irrefutable and uncontestable omnipotence. Not only does this insulate disparate allocations to unsecured creditors from any scrutiny (the horizontal equity violation perpetrated in *GM*), it also necessarily opens the door to allocating new shares to the debtor's old shareholders while squeezing out unsecured creditors—the vertical equity concern addressed in *Boyd* and a host of other critical Supreme Court cases.[3] If "*[t]he allocation of ownership interests in the new enterprise is irrelevant to the estates' economic interests*,"[4] then we will have come full circle in reorganization law, distressing in any event, and all the more disturbing when accomplished *sub silentio*. The equitable receivership will have been raised from the dead, in all its unadorned pre-*Boyd*/*Louisville Trust*/*Howard* glory. Lazarus would be proud indeed.

Moreover, the Second Circuit cleared an unobstructed path "back" to this result. In affirming the *Chrysler* sale, the court's wandering discussion of the *sub rosa* plan objections ultimately just collapsed *sub rosa* plan concerns into the more general preliminary inquiry as to whether a § 363 sale is permissible:

Although *Lionel* did not involve a contention that the proposed sale was a *sub rosa* or *de facto* reorganization, a bankruptcy court confronted with that allegation may approve or disapprove a § 363(b) transfer that is a sale of all or substantially all of a debtor's assets, using the analysis set forth in *Lionel* in order to determine whether there was a good business reason for the sale.

The Indiana Pensioners' arguments boil down to the complaint that the Sale does not pass the discretionary, multifarious *Lionel* test.[5]

Under this approach, *sub rosa* plan doctrine has no independent content at all and thus provides no meaningful check on parties' distribution of the value of a new "purchaser" entity in whatever manner the most powerful interests in control of the process devise. The exigencies warranting an immediate "sale" in both *Chrysler* and *GM* as the best available means of maximizing estate value evidently are also sufficient to warrant distributing that value amongst creditors and shareholders without any apparent restriction. This, we submit, is the

1. Markell, *supra* note 111, at 260.
2. *Gen. Motors*, 407 B.R. at 497 (quoting *In re* Chrysler LLC, 405 B.R. 84, 99 (Bankr. S.D.N.Y. 2009)).
3. *See supra* notes 137–39 and accompanying text.
4. *Gen. Motors*, 407 B.R. at 497 (quoting *Chrysler*, 405 B.R. at 99).
5. *In re* Chrysler LLC, 576 F.3d 108, 117–18 (2d Cir. 2009).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

central danger to the preservation of chapter 11's normative principles posed by *Chrysler* and *GM*.

Ironically, then, the fact that there were no other prospective "purchasers" apart from the government, which allowed the government to dictate all terms of the purchases, including the emergencies necessitating immediate sales, produced *less* judicial oversight and scrutiny of the resulting value allocations rather than *more*. This, of course, was precisely the market defect that caused equity receivership law to evolve in the opposite direction. Now, sadly, we apparently have simply returned to the "bad old days."

The pressure to approve the *Chrysler* and *GM* sales immediately, no matter what, was immense. Moreover, while there was little regard shown for intraclass equity amongst unsecured creditors, the sales did carefully respect creditors' relative interclass priority rights (with no apparent departures from absolute priority) and gave all creditors more than they would have received in an immediate liquidation. The resulting approvals of those sales were, therefore, entirely understandable. In the process, though, they threaten to render *sub rosa* plan doctrine a virtual dead letter, potentially eviscerating even the venerable absolute priority rule.

III. Conclusion: "Repent. The end is near!"

Many years ago, Professor Douglas Baird issued a timeless reminder of a very simple and powerful truth: in a collective, comprehensive, compulsory proceeding like bankruptcy, where we have the ability to completely separate distributional issues from asset-deployment issues, "how much a particular [stakeholder] gets should have *nothing* to do with how a firm's assets are used."[1] As Professor (and former Bankruptcy Judge) Jack Ayer has rightly pointed out, though, the tendency to conflate these separate and distinct concerns (distribution versus asset deployment) "is a common point of confusion."[2] Indeed, it seems that many of the most "successful" perversions of the chapter 11 process rely on the beguiling appeal of equating particular aberrational distribution arrangements (that clearly violate chapter 11's core distributional norms) with the value-maximizing deployment of the debtor's assets.[3]

1. Douglas G. Baird, Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren, 54 U. CHI. L. REV. 815, 820 (1987).

2. John D. Ayer, Bankruptcy as an Essentially Contested Concept: The Case of the One-Asset Case, 44 S.C. L. REV. 863, 870 n.20 (1993).

3. To name just a few of the more extreme examples of this phenomenon: so-called nondebtor "releases," see generally Ralph Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, 1997 U. ILL. L. REV. 959; "critical" vendor orders, see supra note 112; and cross-collateralization or so-called "roll ups" in DIP financing, see generally Charles J. Tabb, A Critical Reappraisal of Cross-Collateralization in Bankruptcy, 60 S. CAL. L. REV. 109 (1986).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

Those touting the benefits of § 363 going-concern sales (versus internal boot-strap reorganizations) often cite the ability of the sale to more clearly and cleanly divide distribution from deployment and thus minimize the extent to which "one creditor or group of creditors has the ability to exploit the reorganization process and receive more than his substantive nonbankruptcy rights entitle him to."[1] What *Chrysler* and *GM* illustrate, though, is that opportunities to conflate distribution and deployment for strategic gain know no bounds. The Second Circuit's *Chrysler* opinion—by ignoring any and all distributional consequences of an asset "sale" for which there is some "good business reason" to "sell" now rather than wait—combined with the ability to structure any conceivable distributional scheme as a nominal "sale" of the debtor's assets, positively invites strategic manipulation and exploitation of the asset-deployment process for distributional advantage.

Viewed in isolation, *Chrysler* and *GM* were understandable aberrations explainable by pressing realities. Unfortunately, though, we doubt that their legacy will be so innocuous. Indeed, the very "nature of Chapter 11 practice," where the stock in trade is akin to that of the hospital emergency room, "tends to quickly transform [even] so-called 'extraordinary' and 'exceptional' relief—to be granted only when absolutely 'necessary' for a successful reorganization—into the ordinary routine."[2] Our concern, therefore, is that the misguided legal principles announced in those cases (as orthodox applications of existing law) will be fully embraced as legitimate and used ever more frequently to further undermine the distributional norms of bankruptcy reorganizations. It is not the shift from reorganization plans to sales, in and of itself, that presages "The End of Bankruptcy."[3] The *Chrysler-GM* model of a "sale" that can also fully reorganize (without restriction), however, very well could herald the end of our entire system of bankruptcy reorganization.

Postscript: The Supreme Court (Quietly) Brackets the Legitimacy of the Chrysler and GM "Sales"

While we have ultimately concluded that the *Chrysler* sale probably was *not* an impermissible *sub rosa* plan of reorganization, the *GM* "sale" most certainly was a *sub rosa* reorganization that violated chapter 11 distributional norms. Unquestioned indulgence of the nominal "sale" structure employed by the proponent parties in *GM* effectively immunized glaringly disparate treatment of unsecured creditors from any scrutiny for "unfair discrimination." Of course, the principal authority on which Judge Gerber relied in *GM* to conclude that the "sale" was not a *sub rosa* plan was none other than the Second Circuit's

1. Douglas G. Baird, The Uneasy Case for Corporate Reorganizations, 15 J. LEGAL STUD. 127, 138–39 (1986).
2. Brubaker, *supra* note 112, at 1.
3. *See* Baird & Rasmussen, *supra* note 69.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

affirmance of the *Chrysler* sale.[1] Six months after the *Chrysler* sale closed, however, the Supreme Court vacated the Second Circuit's *Chrysler* decision.[2] To fully understand what the Supreme Court did and why, though, requires recounting the procedural path plotted by the *Chrysler* sale approval.

After Judge Gonzalez approved the proposed *Chrysler* sale, the Second Circuit stayed consummation of the sale while it heard an expedited direct appeal. The Second Circuit summarily affirmed Judge Gonzalez's approval of the sale at oral argument, and all stays were lifted on June 9. The sale was then closed on June 10, 2009, and on August 5, 2009, the Second Circuit filed its promised opinion explaining its affirmance of the sale.[3]

Shortly thereafter, and notwithstanding closing of the sale, the Indiana Pension Funds, which had appealed the sale order to the Second Circuit, filed a petition for a writ of certiorari with the Supreme Court, seeking a merits review of the Second Circuit's *Chrysler* decision.[4] On December 14, 2009, the Court ruled on that petition as follows:

Petition for writ of certiorari granted. Judgment vacated, and case remanded to the United States Court of Appeals for the Second Circuit with instructions to dismiss the appeal as moot. See *United States v. Munsingwear, Inc.*, 340 U.S. 36 (1950).[5]

Note that the Second Circuit's judgment affirming the *Chrysler* sale was not moot when entered because the court had stayed the sale. Of course, a grant of certiorari by the Supreme Court is theoretically (and in the typical case) meant to enable the Court to review the decision of the court of appeals below on the merits. Because the *Chrysler* sale had in the meantime closed (after the Court vacated Justice Ginsburg's stay[6]), however, further appellate review of the sale was now moot, preventing the Court from actually reviewing the Second Circuit judgment on the merits. What automatically flows from that (in the words of Justice Douglas in the cited *Munsingwear* opinion) is as follows:

The established practice of the Court in dealing with a civil case from a court in the federal system which has become moot while on its way here or pending our decision on the merits is to reverse or vacate the judgment below and remand with a direction to dismiss. That was said in *Duke Power Co. v. Greenwood County*, 299 U.S. 259, 267, to be "the duty of the appellate court." That procedure clears the path for future relitigation of the issues between the

1. *In re* Gen. Motors Corp., 407 B.R. 463, 487, 497–98 (Bankr. S.D.N.Y. 2009).
2. Ind. State Police Pension Trust v. Chrysler LLC, 130 S. Ct. 1015 (2009).
3. *See In re* Chrysler LLC, 596 F.3d 108, 111–12 (2d Cir. 2009); *supra* notes 31–36 and accompanying text.
4. Petition for Writ of Certiorari, Ind. State Police Pension Trust v. Chrysler LLC, 130 S. Ct. 1015 (2009) (No. 09-285), 2009 WL 2864378.
5. *Ind. State Police Pension Trust*, 130 S. Ct. 1015 (parallel citations omitted).
6. Ind. State Police Pension Trust v. Chrysler LLC, 129 S. Ct. 2275, 2276 (2009) (per curiam).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

parties and eliminates a judgment, review of which was prevented through happenstance. When that procedure is followed, the rights of all parties are preserved; none is prejudiced by a decision which in the statutory scheme was only preliminary.

Our supervisory power over the judgments of the lower federal courts is a broad one. As already indicated, it is commonly utilized in precisely this situation to prevent a judgment, unreviewable because of mootness, from spawning any legal consequences.[1]

Of course, there was arguably more than mere happenstance preventing the Court's review of the Second Circuit decision; the Court itself had vacated a stay of the sale, knowing that the sale would immediately close and likely moot further appellate review. Had the Supreme Court simply denied the certiorari petition, the Second Circuit's judgment (and opinion in explanation thereof) would stand with full preclusive and precedential effect. Indeed, the Solicitor General has consistently maintained that this is ordinarily the appropriate course of action in such a case:

The Solicitor General has long taken the position on behalf of the United States that when a case becomes moot after the court of appeals ruled, the Court should decline to vacate the decision below if the case would not have warranted review in the absence of mootness. . . .

It is important at the outset to distinguish between two different categories of cases: those that become moot before a court of appeals has rendered its judgment or after this Court has granted certiorari, and those that become moot after a court of appeals has issued its judgment but before this Court has acted on any petition for certiorari. In the former category of cases, a litigant has a *right* to further review that should not be frustrated by the "vagaries of circumstance." *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 513 U.S. 18, 25 (1994). This Court has accordingly explained that, "[w]here it appears upon appeal that the controversy has become entirely moot, it is the duty of the appellate court to set aside the decree below," *Duke Power Co. v. Greenwood County*, 299 U.S. 259, 267 (1936) (per curiam) . . . . Similar principles govern vacatur of a court of appeals decision when a case becomes moot after this Court has granted a petition for a writ of certiorari.

That rationale for vacatur does not apply, however, where the case becomes moot *after* the court of appeals has entered final judgment and while a petition for a writ of certiorari is pending. A losing party has no right to Supreme Court review, which is discretionary and exercised circumspectly. Mootness during the pendency of a certiorari petition does not provide a basis for vacatur if the case would not otherwise have warranted review by this Court. If the Court would have denied certiorari in any event, there is no unfairness in leaving the lower court's decision intact. As a general rule, where the judgment would not otherwise have been reviewed by this Court, vacatur would disserve

1. United States v. Munsingwear, Inc., 340 U.S. 36, 39–41 (1950) (citations omitted).

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM in Jurnalul de Studii Juridice, Anul V, Nr. 3-4/2010

the public interest by eliminating a judicial precedent that our judicial system regards as "presumptively correct," see *U.S. Bancorp Mortgage*, 513 U.S. at 26, and would give the petitioner a windfall that it would not have received if the controversy had remained live.

Accordingly, the long-standing position of the United States has been that, when a case becomes moot while a petition for certiorari is pending, the petition should be denied if the case would not have warranted review on the merits. See, *e.g.*, U.S. Br. in Opp. at 5–8, *Velsicol Chemical Corp. v. United States*, 435 U.S. 942 (1978) (No. 77-900). Although this Court has never expressly endorsed that standard, the Court has denied certiorari in a number of such cases (including *Velsicol* itself) and has thus decidedly not adopted a policy of automatically vacating the lower court decision whenever a case has become moot while a certiorari petition was pending. To the contrary, the Court "has seemingly accepted the suggestion of the Solicitor General that it need not consider the often difficult question of mootness at the certiorari stage when a case is otherwise not worthy of review. In such cases the Court will merely deny certiorari." Robert Stern et al., *Supreme Court Practice* 724 & n.29 (7th ed. 1993) (footnote omitted).[1]

In *Chrysler*, though, the Court granted certiorari with full knowledge that it would be unable to actually review the Second Circuit decision on the merits and knowing that its grant of certiorari would mandate vacatur of the Second Circuit judgment. Presumably, the Court does that only for "cases in which the Court believes that some or all of the discretionary factors ordinarily governing its certiorari decision point toward a grant, but believes that the case is clearly moot."[2] Indeed, "observation of the Court's behavior across a broad spectrum of cases suggests that the Court denies certiorari in arguably moot cases unless the petition presents an issue (other than mootness) worthy of review."[3]

The Supreme Court, therefore, evidently was sufficiently persuaded that the Second Circuit's *Chrysler* decision warranted further review, and given closing of the sale, this necessitated vacating the Second Circuit decision so that it can no longer be regarded as "presumptively correct." As you might guess, we applaud that result, as we believe the Second Circuit's *Chrysler* opinion was an extremely dangerous precedent. Indeed, the Second Circuit's response to the very legitimate *sub rosa* plan concerns raised by that case was so casual and unconcerned that it threatened to gut all meaning from *sub rosa* plan doctrine, with a realistic potential of entirely eradicating any notion of absolute priority or creditor equality in chapter 11. The formal effect of the Second Circuit decision is now as if it had never issued; but of course, the Second Circuit opinion did issue, and its approach likely will nonetheless (and unfortunately) remain influential in the brave new world of "§ 363 reorganizations."

1. Brief for the Federal Energy Regulatory Commission in Opposition at 11, Enron Power Mktg., Inc. v. N. States Power Co., 528 U.S. 1182 (2000) (No. 99-916), 2000 WL 34005429, at *11–14 (some citations omitted).
2. EUGENE GRESSMAN ET AL., SUPREME COURT PRACTICE § 19.4, at 940 (9th ed. 2007).
3. *Id.* at 939 n.33.

BRUBAKER, R., TABB, C., (2010) BANKRUPTCY REORGANIZATIONS AND THE TROUBLING LEGACY OF CHRYSLER AND GM
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