THE CHRYSLER BANKRUPTCY AND THE FUTURE OF 363(b) TRANSACTIONS

I. INTRODUCTION

A. *Chrysler Files for Chapter 11 Bankruptcy*

In the wake of the financial crisis that has wrecked the American manufacturing industry, and in particular the automobile industry, Chrysler LLC ("Chrysler") and twenty-four of its subsidiaries filed for Chapter 11 bankruptcy protection and reorganization in April 2009 as a means to reconstitute and revive its operations.[1] As a last ditch attempt to buoy Chrysler's operations, the Treasury Department gave the corporation a four billion dollar loan through the Troubled Asset Relief Program ("TARP").[2] This federal assistance proved insufficient.[3] Chrysler's Chapter 11 petition marked the first time since 1933 that a major automaker sought bankruptcy protection.[4] Chrysler's decision to file for bankruptcy was the result of a six week process beginning in February 2009. The corporation gave the Treasury Department, possibly as a precondition to receive TARP funds, three plans illustrating possible directions it might take to survive.[5] These plans included a "stand-alone restructuring" plan, a cessation of operations plan, and the bankruptcy plan.[6] Chrysler's preferred course of action, the

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1. *In re* Chrysler, 405 B.R. 84, 87-88 (Bankr. S.D.N.Y. 2009). Chrysler's debt at the time of its bankruptcy filing was 5.34 billion dollars. *Id.* at 90. Chapter 11 bankruptcy, as discussed *infra*, is not a "kiss of death" procedure for a debtor. *See* discussion *infra* Part III.B.2. Under Chapter 11, a debtor reorganizes its business and restructures its payment commitments during either a three or five year period to meet certain benchmarks that will allow it to emerge as a viable business entity. 11 U.S.C. § 1325(b)(4)(B) (2006). To be sure, should the debtor not show it can meet these benchmarks, the Chapter 11 bankruptcy may be converted to a Chapter 7 bankruptcy: a liquidation of the debtor's assets, and a true kiss of death. *See* 11 U.S.C. § 1112 (2006).

2. *Chrysler*, 405 B.R. at 89-90. TARP allowed the Treasury Secretary "to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution . . ." 12 U.S.C. § 5211(a)(1) (2008). *See also In re* Chrysler, 405 B.R. at 89. TARP was a product of the Emergency Economic Stabilization Act ("Act"), passed by Congress on October 3, 2008. *Id.* The Treasury Department's provision of TARP funds to Chrysler does not seem to fall directly under one of the explicit purposes of the Act. *See* 12 U.S.C. § 5201 (2008). The closest possible purpose involves the provision of funds for "promot[ing] jobs and economic growth." *Id.* § 5201(2)(B).

3. *See Chrysler*, 405 B.R. at 89-90 (explaining that despite the four billion dollar loan, Chrysler still applied for bankruptcy).

4. Jim Rutenberg & Bill Vlasic, *Chrysler Files to Seek Bankruptcy Protection*, N.Y. TIMES, Apr. 30, 2009, *available at* http://www.nytimes.com/2009/05/01/business/01auto.html.

5. *Chrysler*, 405 B.R. at 91.

6. *Id.*

bankruptcy plan, was determined to be viable in late March 2009 following a federally sponsored evaluation.[7]

B. *Fiat and the Master Transitory Agreement*

In January 2009, prior to Chrysler's bankruptcy decision that month, Italian automaker Fiat S.p.A ("Fiat") agreed to purchase thirty-five percent of Chrysler's equity to help the troubled automaker.[8] To facilitate the transaction, Fiat created New CarCo Acquisition LLC ("New Chrysler").[9] Following Chrysler's bankruptcy decision, Chrysler and Fiat executed this sale, calling it the "Master Transaction Agreement" ("MTA"), in conjunction with the Chapter 11 filing and as part of Chrysler's reorganization plan.[10] Possibly the most noteworthy feature of this transaction was that it was not a straight cash sale.[11]

The MTA was established through § 363(b) of the Bankruptcy Code ("Code"). This subsection allows for a Chapter 11 debtor-in-possession to "sell, use, or lease, other than in the ordinary course of business, property of the estate . . . free and clear of any interest in such property."[12] Essentially, Chrysler aimed to transfer substantially all of its operating assets outside

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7. *See id.*

8. *Id.* at 90.

9. *Id.* at 91-92.

10. Donald S. Bernstein & Marshall S. Huebner, Comment to *Implications of the Sale of Chrysler*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION BLOG (Jun. 3, 2009, 2:22 AM), http://blogs.law.harvard.edu/corpgov/2009/06/03/implications-of-the-sale-of-chrysler/ (noting that the MTA essentially called for Chrysler to sell its operating assets to the reconstituted Chrysler). Fiat actually formed New Chrysler to serve as the alliance organization. *Chrysler*, 405 B.R. at 92. The interests of Chrysler's creditors would not transition to New Chrysler. *Id.* at n.10. The MTA entailed the transfer of Chrysler's assets to New Chrysler in exchange for two billion dollars. *Id.* at 92.

11. Nouriel Roubini, *The Impact of Chrysler's Bankruptcy: Lessons for GM – and for the Rest of Us*, FORBES, May 7, 2009, http://www.forbes.com/2009/05/06/ chrysler-gm-fiat-bankruptcy-opinions-columnists-nouriel-roubini.html (indicating that "Fiat w[ould] provide the equivalent of billions of dollars in research- and investment-related (R&D) investments for a 35% stake in the new Chrysler). To be sure, Chrysler received two billion dollars in cash from New Chrysler in exchange for its operating assets, as mentioned. *Chrysler*, 405 B.R. at 92. New Chrysler would also assume certain liabilities of Chrysler, and Fiat would provide Chrysler with new technology, capabilities, and markets. *Id.* at 90-92.

12. 11 U.S.C. § 363(b), (d) (2006). Sections 363 and 1123 are the two Code provisions allowing for a Chapter 11 sale. See *infra* Part III.B. After a debtor files for bankruptcy protection, its assets constitute the property of the bankruptcy estate save for some exclusions. *See* 11 U.S.C. § 541(a) (2006), (outlining assets falling in the bankruptcy estate); 11 U.S.C. § 541(b) (2006) (listing exclusions to § 541(a)). The bankruptcy estate is the source of funds through which a Chapter 11 debtor meets its payments in a reorganization plan. 11 U.S.C. § 1123 (a)(5)(D) (2006).

and prior to a reorganization plan.[13] A small group of creditors resisted this move, as their objection wound through bankruptcy court,[14] to the Court of Appeals for the Second Circuit,[15] and to the Supreme Court, which ultimately allowed the sale.[16]

The implications of allowing Chrysler's reorganization to move forward are significant because they evoke a clash of competing principles on a number of levels. A 363(b) transaction allows a debtor to transfer assets and thus restructure its business outside the rigorous requirements of Chapter 11; this, however, clashes with the Code's purpose of ensuring fairness in the bankruptcy process.[17] Moreover, the benefits Chrysler would receive from the sale clash with traditional creditor-debtor and creditor priority laws. At a policy level, the federal government's desires for maintaining a component of an institution of American industry clash with the equally entrenched principles of equity and investment. This casenote will explore the history surrounding the Chrysler bankruptcy, focusing on the history of the type of sale between Fiat and Chrysler, a 363(b) transaction, vis-à-vis the Chapter 11 bankruptcy process. This discussion will provide the framework for addressing the bankruptcy court's ruling against the creditor's objection. This casenote will then connect the Chrysler bankruptcy and the analogous General Motors bankruptcy and conclude with some discussion on the directions regarding the short and long-term ramifications of Chrysler's bankruptcy.

II. OBJECTIONS TO THE FIAT SALE

A. *Pension Trust's Automatic Stay*

On May 19, 2009, a group of Indiana state employee retirement funds ("Pension Trust"), which held 42 million dollars of Chrysler's debt, or .061%, objected to the Fiat sale on a number of grounds.[18] The most salient objection was that Chrysler's

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13. *See Chrysler*, 405 B.R. at 90-92.

14. *Chrysler*, 405 B.R. at 93.

15. *In re* Chrysler, 576 F.3d 108, 111 (2d Cir. 2009).

16. *See* Indiana State Police Pension Trust v. Chrysler, 129 S. Ct. 2275 (2009) (denying application for a stay). Ultimately, the sale under subsection 363(b) and ensuing bankruptcy would result in the following equity interests in New Chrysler: 9.85% for the U.S. Government, 2.46% for the Canadian Government, 67.69% for a fund for Chrysler employees' health care, and 20% for Fiat with a conditional increase to 35% and the right to acquire an additional 16%. *Chrysler*, 405 B.R. at 92 n.11.

17. 11 U.S.C. § 362(b) (2006).

18. *Chrysler*, 405 B.R. at 93. Pension Trust exercised its right to object via subsection 1109(b) of the Code, which allows that any "party in interest" in a bankruptcy

363(b) sale to Fiat and New Chrysler constituted a *sub rosa* reorganization plan that, by virtue of it being outside the rubric of Chapter 11, did not follow the priority scheme of the Code.[19] The argument was that it distributed the proceeds from the sale of Chrysler's assets, the collateral of Chrysler's first lien lenders, to unsecured trade creditors and the United Auto Workers ("UAW").[20] Moreover, in its petition to the Supreme Court for a stay of the sale, Pension Trust claimed Treasury Department actions in providing TARP funds intended for Chrysler's restructuring and demanded judicial review, which did not occur at the bankruptcy court level.[21] Pension Trust also claimed that the Chapter 11 reorganization was not consistent with Code

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case "may raise and may appear and be heard on any issue." 11 U.S.C. § 1109(b) (2006). Section 363(b) allowed Pension Trust to exercise this objection via its "notice and a hearing" requirement for all proposed transactions under the section. 11 U.S.C. 363(b)(1) (2006). Pension Trust's funds were part of a ten billion dollar "First Lien Credit Agreement" established in November 2007, set to mature in August 2013, and secured by Chrysler's assets. *Chrysler*, 405 B.R. at 89. Chrysler owed the lenders of this agreement 6.9 billion dollars on the date of its bankruptcy petition. *Id.* Chrysler also had an additional two billion dollar credit agreement due in February 2014 that held second-priority interest in the same assets. *Id.; see* Malani J. Cademartori & Blanka Wolfe, *The Precedential Value of an Unprecedented Sale – Lessons from Chrysler*, BANKRUPTCY & RESTRUCTURING BLOG (Jul. 14, 2009, 9:49 PM), http://www.bankruptcylawblog.com/assets-sales-and-acquisitions-the-precedential-value-of-an-unprecedented-sale-lessons-from-chrysler.html (listing all of Pension Trust's objections).

19. *See* Cademartori et al., *supra* note 18.

20. *Chrysler*, 405 B.R. at 93; Cademartori et al., *supra* note 18. Pension Trust noted that in Chrysler's First-Lien Agreement, creditors were to receive 29 cents on the dollar for the "cram down" sale of collateral, and that the general, unsecured deficiency claim from that collateral would be subordinated to the unsecured trade debt. *Chrysler*, 405 B.R. at 93. In certain circumstances, bankruptcy law allows a creditor's collateral to be sold and to turn the difference in sale's value and the amount owed to the creditor, called a deficiency, into a general unsecured claim that is subordinated to the Code's priority structure for prioritized unsecured claims. 11 U.S.C. §§ 506(a)(1), 507(a) (2006). Under Chapter 11, a creditor class can accept a proposed reorganization plan through at least two-thirds vote in dollar value within each class. 11 U.S.C. § 1126(d) (2006). Even if a creditor class does not approve a plan, the bankruptcy court can approve the plan through its "cram down" power. 11 U.S.C. § 1128(a) (2006). However, at least one creditor class must approve of the plan as a prerequisite for a "cram down." 11 U.S.C. § 1129(a)(10) (2006). Pension Trust also asserted that its place as a senior lien-holder was subordinated to a number of secured and unsecured creditors, including the federal government, Canada, the UAW, and the employees' retirement fund. *Chrysler*, 405 B.R. at 93. In a short speech on April 30, 2009 about the Chrysler bankruptcy, President Barack Obama described Pension Trust as "a small group of speculators" who were "endanger[ing] Chrysler's future by refusing" to make sacrifices all other stakeholders in Chrysler were making to keep the company operating. Press Release, President Barack Obama, Remarks by the President on the Auto Industry (Apr. 30, 2009) (on file with author), *available at* http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-Auto-Industry/. Section 507 of the Code contains the priority scheme for unsecured creditors for all types of bankruptcy cases. 11 U.S.C. § 507 (2006).

21. *In re* Chrysler, No. 08-A1096, 2009 WL 1611729, at *2-3 (2d Cir. June 6, 2009).

provisions, as secured creditors would receive significantly less value following the sale of Chrysler's collateral.[22]

B. *Procedural History*

Chrysler filed its Chapter 11 petition on April 30, 2009, in the United States Bankruptcy Court for the Southern District of New York.[23] The court approved the Chrysler sale on May 31, 2009 pursuant to Federal Rule of Bankruptcy Procedure ("Bankruptcy Rule") 9019.[24] The Second Circuit granted a stay on June 2, 2009.[25] As Circuit Justice for the Second Circuit, Justice Ruth Bader Ginsburg entered a temporary stay on June 8, 2009, to give the Supreme Court time to address Pension Trust's claims.[26] In a two page opinion limited to the "record and proceedings" of the case, the Supreme Court denied the requested stay the next day and vacated Ginsburg's temporary stay one week later, stating that the Indiana pensioners failed to meet their burden of showing their claims merited the Court's discretion to grant a stay.[27] The following day, Fiat and Chrysler conducted their transaction, concluding a process that lasted roughly forty-two days.[28]

III. 363(b) TRANSACTIONS AND *SUB ROSA* PLANS

A. *Anatomy of a 363(b) Transaction*

As mentioned, the heart of Pension Trust's objection to the Fiat-Chrysler sale under § 363(b) of the Code was that the sale constituted a *sub rosa*, and thus "secret" plan of reorganizing Chrysler's assets that should have been conducted within

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22. *Id.*

23. *Chrysler*, 405 B.R. at 87-88.

24. *Id.* at 113. Bankruptcy Rule 9019 provides that "on motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement." FED. R. BANKR. P. 9019(a). Unlike Chapter 7 bankruptcy cases in which a trustee is appointed by the bankruptcy judge to manage the debtor's estate, Chapter 11 cases allow the debtor to serve as its own trustee. 11 U.S.C. § 1107 (2006). In one case, the Second Circuit described the function of Rule 9019 as bringing to light "concealed agreements which are unknown to creditors and unevaluated by the court" for the ultimate purpose of determining if settlements are fair and equitable. *In re* Iridium Operating LLC, 478 F.3d 452, 461-62 (2d Cir. 2007) (quoting *In re* Masters, Inc., 141 B.R. 13, 16 (Bankr. E.D.N.Y. 1992), *aff'd*, 149 B.R. 289 (E.D.N.Y. 1992)).

25. *In re* Chrysler, No. 09-2311-mb, 2009 WL 1532959, at *1 (2d Cir. June 2, 2009).

26. Indiana State Police Pension Trust v. Chrysler, 129 S. Ct. 2275, at *2276 (2009).

27. *Id.*

28. Michael J. de la Merced & Micheline Maynard, *Fiat Deal With Chrysler Seals Swift 42-Day Overhaul*, N.Y. TIMES, Jun. 10, 2009, *available at* www.nytimes.com/2009/06/11/business/global/11chrysler.html.

Chrysler's reorganization plan under Chapter 11 of the Code.[29] In other words, Pension Trust accused Chrysler of completing a preemptive end-around sale with its assets in order to avoid selling them in a bankruptcy process, where Chrysler would have to account for the interests of numerous creditors and possibly equity holders.[30]

A 363(b) transaction takes its name from 11 U.S.C. § 363, the provision in a bankruptcy reorganization which allows for the "use, sale, or lease other than in the ordinary course of business . . . [of] property of the estate" that is "free and clear of any interest in such property of an entity other than the estate . . ."[31] 363(b) transactions apply to all types of bankruptcy cases, but feature most prominently Chapters 7, 11, and 13 cases.[32] They are conducted prior to the confirmation of a proposed plan.[33] That is, a debtor files for a particular type of bankruptcy, placing an automatic stay under § 362 of the Code on its assets and all transactions related to those assets in order to establish the bankruptcy estate that becomes subject to a

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29. Elizabeth Rose, Comment, *Chocolate, Flowers, and § 363(B): The Opportunity for Sweetheart Deals Without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 249-53 (2006) (offering a succinct overview on the practice of using and selling Chapter 11 petitioner assets outside of a reorganization plan). Rose states that the practice has been contentious since its enactment through Chapter X of the Chandler Act of 1938 § 116(3), 11 U.S.C. § 516(3) (1938), *repealed by* Bankruptcy Act of 1978, 11 U.S.C. § 363(b) (1978). *Id.* at 252-53. She notes the paradox between the practice and the function of reorganization plans, where the former's less structured guidelines appear to undermine the latter's rigorous standards aimed at optimizing benefits for all parties involves in a plan. *Id.* This paradox remains apparent when comparing subsection 363(b) and section 1123, as discussed *infra* in Part III, Section B. Indeed, Rose raises an irony of 363(b) transactions: by "circumvent[ing] the time-consuming and expensive process of [a bankruptcy] plan confirmation and offer[ing] an attractive streamlined process for business sales," debtors could use them for business agreements completely unrelated to bankruptcy. *Id.* at 253.

30. Petition for Immediate Stay of Sale Orders Issued by Bankruptcy Court at *6; Indiana State Police Pension Trust v. Chrysler, No. 08-1513, 2009 WL 1611729, at *2276 (U.S. June 9, 2009).

31. 11 U.S.C. § 363(b)(1), (f) (2006); *see also* George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L.J. 235, 236-37 (2002) (noting that while subsection 363(f) allows only the sale of the debtor's assets "free of any interests," bankruptcy courts have read that to mean "'any claim or interest' so as to give the debtor or trustee the same power to sell prior to plan confirmation as that under a confirmed claim, and to strip off liens, claims and other interests in the process," thus resulting in a quick-encumbrance-free, and ready for sale asset).

32. *In re* Chrysler, 576 F.3d 108, 127 n.3 (2d Cir. 2009), *vacated*, 592 F.3d 370 (2d Cir. 2010).

33. *See* Rose, *supra* note 29, at 260 (noting that "with a § 363 sale, fewer people receive less information, and the lack of a disclosure requirement weakens creditor leverage when compared with that leverage they may have had with a Chapter 11 plan confirmation").

bankruptcy plan under § 541.[34] Between the time the bankruptcy estate is determined and the debtor's plan is confirmed, the debtor may execute a 363(b) transaction involving the bankruptcy estate, thus changing its make-up before the bankruptcy process is applied.[35] The bankruptcy judge initially determines whether the 363(b) transaction is valid under the Code.[36] As in Chrysler's case, a 363(b) transaction in a Chapter 11 bankruptcy comes within the context of a debtor, most often a corporation or partnership, attempting to restructure its business to meet its obligations for a set period of time, with the ultimate aim of reconstituting itself in some form.[37]

The Second Circuit courts which heard *Chrysler* cited a case in which the Supreme Court appeared to indirectly approve of 363(b) transactions in a case involving Chapter 11 disputes.[38]

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34. 11 U.S.C. §§ 362, 541 (2006).

35. Trustees-in-bankruptcy ("TIBs"), outside third parties, manage the bankruptcy estate for Chapter 7 debtors, and sometimes those of Chapter 11 and 13 debtors. 11 U.S.C. § 704 (2006) (defining the duties of a trustee). A TIB has a fiduciary responsibility to all parties with a stake in a bankruptcy and is charged with collecting and managing the debtor's estate. *Id.* Most often, debtors acting as their own trustees, called debtors-in-possession ("DIPs"), manage their own property. *See* 11 § U.S.C. 1101(1) (2006) (defining debtor in possession); *see also In re* Bonded Mailings, Inc., 20 B.R. 781, 785 (Bankr. E.D.N.Y. 1982) ("Under chapter 11, it is generally presumed that the debtor will continue in possession."). While DIPs maintain the same fiduciary responsibility as TIBs, it is obvious the likelihood for conflicts of interest emerge more often with DIPs than TIBs. *See, e.g.*, Thomas E. Plank, *The Bankruptcy Trust as a Legal Person,* 35 WAKE FOREST L. REV. 251, 278-79 (discussing potential conflicts for a DIP).

36. *See* Teri Rasmussen, Ohio Practical Business Law, *363 Bankruptcy Sale FAQ – What You Need to Know to Understand What's Going On with Chrysler and GM*, http://www.ohiopracticalbusiness law.com/2009/05/articles/bankruptcy/363-bankruptcy-sale-faq-what-you-need-to-know-to-understand-whats-going-on-with-chrysler-and-gm/ (last viewed April 20, 2011) (discussing the four requirements for a bankruptcy judge to approve a 363 sale: "(1) Whether the terms of the sale constitute the highest and best offer for the assets to be sold; (2) Whether the negotiations concerning the terms and conditions of the proposed sale were conducted at arm's length; (3) Whether the sale is in the best interests of the bankruptcy estate and its creditors; and (4) Whether the purchaser has acted in good faith and the sale itself is being made in good faith").

37. Unlike individuals who could submit to a plan to meet their obligations under Chapter 13 or 11, corporations and partnerships can only do so under Chapter 11. 11 U.S.C. § 109(e) (2006). Reorganization, however, concerns Chapter 11. *See* Craig A. Sloane, *The Sub Rosa Plan of Reorganization: Side-Stepping Creditor Protections in Chapter 11,* 16 BANKR. DEV. J. 37, 41 (1999).

38. Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33, 37 n.2 (2008) [hereinafter Piccadilly Cafeterias]; s*ee, e.g.*, *In re* General Motors, Corp., 407 B.R. 463, 488 (Bankr. S.D.N.Y. 2009). Beyond the Supreme Court's statements in *Piccadilly Cafeterias*, little commentary exists from ultimate authority on subsection 363(b). The use of subsection 363(b) for selling virtually all of a Chapter 11 debtor's assets was well-established prior to Chrysler's bankruptcy. *Cf. In re* Burke Mountain Recreation, Inc., 56 B.R. 72, 73 (Bankr. D. Vt. 1985) (discussing sale under subsection 363(b), relying on factors laid out in *In re* Lionel Corp., 722 F.2d 1063 (2d Cir. 1983)). Yet the legislative history of subsection 363(b) makes no statement regarding congressional intent. *Cf.* Gerald I. Lies, LL.M. Theses, *Sale of A Business in Cross-Border Insolvency: The United*

The Court interpreted the language of subsection 1129(a)(11) of the Code, which states that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor," to indicate the Code allowed § 363(b) to be the vehicle by which a debtor could fulfill these duties prior to entering into its Chapter 11 plan.[39]

B. *Transactions Under 363 v. 1123*

1. Transfers of Property "Free and Clear"

The significance of a 363(b) transaction emerges when comparing it to analogous provisions in § 1123 of the Code. Section 1123 allows for the "transfer of all or any part of the property of the estate,"[40] the "sale of all or any part of the property of the estate, either subject to or free from any lien,"[41] and "provide[s] for the sale of all or substantially all of the property of the estate."[42] Like § 363(b) transactions via § 363(f), these transactions are "free and clear of all claims and interests of creditors" via subsection 1141(c).[43] But where a § 363(b) transaction only requires a "notice and a hearing" under the bankruptcy judge, transactions under § 1123 are subject to a constellation of requirements prior to their approval.[44] Thus, a § 363(b) sale is appealing because it

> allows the debtor to not only 'cherry pick' advantageous protections from Chapter 11, but also to achieve a quick approval for the sale of all or substantially all of its assets without complying with Chapter 11 requirements for plan confirmation . . . The preplan business sale is attractive to debtors because of its ease, speed, and

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States and Germany, 10 AM. BANKR. INST. L. REV. 363, 369-75 (2002) (discussing the history of subsection 363(b) and interpretations thereof arguing varying extents of authorized sales pursuant to 363(b)). The changes to the Code in 1994 contain no substantial amendments to subsection 363(b). Bankruptcy Reform Act of 1994, Pub. L. 103-394 § 109. The 1984 amendments added part 363(b)(2) to the subsection, but offer no information on how Congress intended the subsection to fit in the overall scheme of Chapter 11. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353 § 442(b).

39. *Piccadilly Cafeterias*, 554 U.S. at 37 n.2.

40. 11 U.S.C. § 1123(a)(5)(B) (2006).

41. *Id.* § 1123(a)(5)(D).

42. *Id.* § 1123(b)(4).

43. *Id.* § 1141(c); *see, e.g., In re* Gulf Coast Oil Corp., 404 B.R. 407, 414-15 (Bankr. S.D. Tex. 2009) (comparing the characteristics and prerequisites of § 363(b) and § 1123 sales).

44. 11 U.S.C. §§ 363(b)(1), 1123 (2006).

> finality. The lack of transparency, the pace of the process, and the inconsistent treatment by the courts, however, leave the bankruptcy courts and parties in interest vulnerable to unfair dealing, abuse, and sweetheart deals.[45]

Moreover, stripped of their liens and interests, these assets are considerably more attractive to potential purchasers.[46] Buyers might be willing to pay more for these assets, which would generate more funds for the debtor to deploy according to the stipulations of the eventual bankruptcy plan.

Thus on one hand, 363(b) transactions provide a potential means for debtors to improve their performance in anticipation of their impending Chapter 11 plan.[47] On the other hand, the dearth of requirements under § 363 provides ample opportunity to engage in questionable transactions.[48] Regardless of the intentions of the parties, the same transaction under Chapter 11 would produce greater scrutiny because a reorganization plan protects the rights of creditors' claims.[49] Sections 1125, 1126, and 1129 of the Code fulfill this function by subjecting transactions under subsections 1123(a) and (b) to seemingly more rigorous standards, transactions that if proposed prior to the proposed plan under section 363(b) might have a greater chance of approval.[50]

2. The Rigors of a Chapter 11 Transaction

Chapter 11 requirements for plan approval begin with notification to creditors and other parties with impaired claims,

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45. Rose, *supra* note 29, at 249-50; *see also id.* at 249-52 (tying the increased use of Chapter 11 provisions, such as a 363(b) transaction to a theory behind the purpose of a Chapter 11 bankruptcy plan which considers the assets of firms within bankruptcy to be of more value in themselves than what they do in terms of performance).

46. *See, e.g.*, George W. Kuney, *Hijacking Chapter 11*, 21 BANKR. DEV. J. 19, 25, 105-06 (2004).

47. *Id.* at 105.

48. Kuney, *supra* note 46, at 109 (noting that insiders stand to benefit from 363(b) transactions if "the majority of their post-petition compensation is tied to the sale of the corporation or where they expect to be employed by the purchaser post sale"). Indeed, Kuney in large part views 363(b) transactions not as a tool to undermine the bankruptcy process's rigorous measures to insure the interests of all creditors and equity holders, but as one that secured creditors induce insiders associated with debtors to use to "cooperate (with those secured creditors) through retention programs, temporary stays of litigation against them, and promises of inclusion in a permanent blanket release of liability." *Id.* at 110-11.

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

50. *See* 11 U.S.C. §§ 1125, 1126, 1129 (2006).

extend to voting, and demand protection of creditor interests.[51] The Code calls for the debtor to file a disclosure statement containing "adequate information . . . that would enable . . . a hypothetical investor . . . to make an informed judgment about the plan . . ." which is "transmitted to each holder of a claim or interest . . . ."[52] Following adequate disclosure, the proposed plan is put to a vote in which a debtor obtains approval only if at least two-thirds of the total amount of interest of each class of creditors or interest holders approves.[53] The purpose of the adequate disclosure requirement is to provide ample information to creditors for making informed votes.[54] Even if a plan is approved, a bankruptcy court must still confirm a plan and can only do so if the plan meets all 12 requirements of subsection 1129(a) of the Code.[55] The "best interests of the creditors" test under § 1129(a)(7) is among the most significant requirements. This standard is applied to every creditor, not each class of creditors.[56] It calls for creditors who do not vote for the proposed plan to "receive at least as much under the plan as [they] would have received in a liquidation under Chapter 7."[57] Under § 1129(a)(8), the majority of creditors of each class must accept the plan.[58] A bankruptcy judge, however, might still approve the proposed plan should it meet certain requirements under § 1129(b), a process known as a "cram down."[59] Under this

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51. 11 U.S.C. § 342 (2006) (notice requirement); 11 U.S.C. § 1325 (2006) (plan confirmation generally). A bankruptcy plan groups creditors by types of claim into classes. 11 U.S.C. § 1122 (2006). Creditors holding "impaired" claims can vote on the plan, and plan acceptance is contingent on the vote of at least one impaired class. 11 U.S.C. § 1126 (2006). A claim is "impaired" if the proposed plan would alter it in any way. 11 U.S.C. § 1124 (2006).

52. 11 U.S.C. § 1125(a), (c) (2006).

53. *Id.* § 1126(c), (d).

54. *See* Rose, *supra* note 29, at 282 ("Information-dispersal to creditors and claims holders is critical to informed participation and debtor oversight. Also, equal access to information greatly encourages parties in interest negotiations that more sufficiently legitimize purchase price and valuation.").

55. 11 U.S.C. § 1129(a) (2006).

56. *Id.* § 1129(a)(7)(A).

57. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS 624 (Vicki Been et al. eds., Wolters Kluwer, 2009) (2003).

58. 11 U.S.C § 1129(a)(8) (2006).

59. 11 U.S.C. § 1128(a) (2006). A plan must have at least one consenting class of creditors to meet approval under subsection 1129(b). *Id.* § 1129(a)(10). Chrysler's bankruptcy contained a "cram down" incident involving First-Lien lenders. *See In re* Chrysler, No. 08-A1096, 2009 WL 1611729, at *3, 28 (2d Cir. June 6, 2009).

section, a plan may not discriminate against creditor classes and be "fair and equitable."[60]

3. The Ease of a 363(b) Transaction

The type of transaction allowed under 363(b) could also be conducted within a reorganization plan.[61] But under 363(b), that transaction is free from those numerous Chapter 11 procedures aimed at ensuring fairness to a debtor's interest holders.[62] So while they might "circumvent the time-consuming and expensive process of plan confirmation and offer an attractive streamlined process for business sales," their "diminished court oversight also increases vulnerability to unfair dealing and sweetheart deals."[63] Unlike a transaction within the Chapter 11 context, discussion within creditor classes does not exist with a 363(b) transaction.[64] A 363(b) transaction also strips all creditors of their voting power.[65] Moreover, the lack of adequate disclosure might not supply them with sufficient knowledge about how the 363(b) transaction in question would affect their claims.[66] In addition, within the notice and hearing requirement, a creditor objecting to a 363(b) transaction bears the burden of proof, and this lack of knowledge may result in a weaker objection.[67] Coupling that with the mere twenty days in which to respond to a 363(b) transaction[68] renders a potential objector essentially restricted in comparison with an objector to a transaction under Chapter 11.[69]

The grand irony of a 363(b) transaction within the context of a Chapter 11 bankruptcy thus emerges. A 363(b) transaction

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60. 11 U.S.C. § 1129(b)(1) (2006); *see* WARREN & WESTBROOK, *supra* note 57, at 662-63 (explaining the minimum requirements under subsection 1129(b) and their division into three categories, subsections 1129(b)(2)(A)-(C)).

61. *See* 11 U.S.C. § 363(b).

62. *See id.*

63. Rose, *supra* note 29, at 253.

64. *See* 11 U.S.C. § 363(b).

65. *Id.* While Chrysler's bankruptcy involved an objection to a 363(b) transaction by a secured party, unsecured creditors potentially stand to lose more than secured creditors. Even though unsecured creditors hold less sway over the course of a debtor's business than their secured counterparts, the bankruptcy process, as an effect of its overarching aim of preserving fairness to all parties, affords them a measure of leverage through allowing voting, confirmation, and payment privileges. The transfer of a debtor's assets under 363(b) may result in a decreased payout to unsecured creditors, who would have a more limited recourse to object to the transaction than if it were under Chapter 11. *See* 11 U.S.C. § 363(b).

66. *See* Rose, *supra* note 29, at 260.

67. *Id.*

68. FED. R. BANKR. P. 2002(a).

69. Moreover, § 363(m) renders appeals to these transactions moot, unless the objector obtains a stay, as Pension Trust did, or the transaction was not conducted in good faith. 11 U.S.C. § 363(m) (2006).

could result in the sale of virtually all of a debtor's assets that would essentially effect a reorganization of the debtors business, which should be the purview of a Chapter 11 reorganization.[70] Therefore, Chapter 11 contains a broad provision that potentially undermines itself. The benefits of a § 363(b) transaction logically extend to debtors because a debtor can make the Chapter 11 bankruptcy process a means of conducting a sale or a reallocation of assets, which would curb liability and thus undermine the purpose of the Code.[71] Indeed, should a debtor succeed in selling all of its assets through a 363(b) transaction, that transaction itself could be tantamount to a liquidating plan, normally the purpose of Chapter 7.[72] Where Chapter 7 liquidation most often pertains to total liquidation of a debtor's assets as the function of the bankruptcy plan, a Chapter 11 liquidation via 363(b) occurs prior to the approval of the bankruptcy plan.[73]

4. Judicial Power Under 363(b) and 1123

In addition to constituting a set of procedures to keep a debtor's transactions in check, Chapter 11 provisions on plan approval keep a bankruptcy judge's power to allow a transaction in check.[74] Where a judge is bound to follow the provisions of § 1129(a) and (b) of the Code, § 363 contains no provisions to limit a judge's authority under subsection 105(a).[75] Indeed, while a judge might be able to cram a plan down the necks of creditors, the judge could only do so after a plan passes through the § 1129(a) disclosure and voting requirements and corresponds with subsection 1129(b) requirements.[76] *Contrarian Funds, LLC v. Westpoint Stevens, Inc.* (*Westpoint*), a bankruptcy case in the Second Circuit's jurisdiction, illustrates these Chapter 11 plan

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70. 11 U.S.C. § 363(b) (2006).

71. *See* Kuney, *supra* note 46, at 236.

72. 11 U.S.C. § 726 (2006).

73. *See* Rose, *supra* note 29, at 261 (noting that an allegedly disinterested trustee carries out a liquidation plan under Chapter 7, whereas the DIP who is anything but disinterested carries out a virtual liquidation plan via a § 363(b) transaction).

74. 11 U.S.C. § 1129(a)-(b) (2006).

75. Subsection 105(a) allows the court to

> "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title . . . shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."

11 U.S.C. § 105(a) (2006).

76. *See* WARREN & WESTBROOK, *supra* note 57, at 624.

restrictions.[77] In this case the bankruptcy judge, through the broad powers afforded in § 105(a), attempted to cram down a proposed plan that did not meet § 1129(b) requirements.[78] The *Westpoint* court noted that § 105(a) "[did] not authorize bankruptcy courts to ignore Code requirements simply because they might constitute barriers to otherwise desirable outcomes."[79] The court highlighted the Supreme Court's decision in *Norwest Bank Worthington v. Ahlers*, in which it found against the confirmation of a reorganization plan that side-stepped the absolute priority requirement of § 1129(b)(2).[80] In *Westpoint*, the bankruptcy court justified its exercise of § 105(a) authority by reasoning that the proposed plan's outcome would prove more equitable to some parties.[81] In asserting that a bankruptcy judge cannot use subsection 105(a) to circumvent Code requirements, the Supreme Court stated that the Code "provides that it is up to the creditors – and not the courts – to accept or reject a reorganization plan which fails to provide them adequate protection or fails to honor the absolute priority rule."[82] The Supreme Court added that while other parties connected to a bankruptcy case would benefit more from a plan confirmation, "that determination is for the creditors to make in the manner specified by the Code."[83]

5. Due Process and 363(b) Transactions

As discussed above, the hurdles to achieving a 363(b) transaction, particularly one involving liquidation of a debtor's assets, are a mere notice and a hearing because the transaction occurs outside the sphere of a Chapter 11 reorganization plan. Hence the 363(b) transaction, which could be achieved within a plan, is not subject to the same Chapter 11 requirements "designed to compel the debtor to negotiate with its creditors and other interest holders to formulate a plan of reorganization that is acceptable to all interested parties."[84] In addition to the issue of hamstringing creditors' rights by conducting transactions outside of Chapter 11, an additional question emerges concerning

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77. *See* Contrarian Funds, LLC v. Westpoint Stevens, Inc. (*In re* Westpoint Stevens), 333 B.R. 30, 49-50 (Bankr. S.D.N.Y. 2005) (containing possibly some of the most strongly worded language opposing 363(b) transactions by a Second Circuit court).

78. *Id.* at 54.

79. *Id.*

80. *Id.*; Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202-03, 206 (1988).

81. *WestPoint*, 333 B.R. at 53-54.

82. *Norwest Bank*, 485 U.S. at 207.

83. *Id.*

84. Sloane, *supra* note 37, at 40.

due process rights. That is, even though creditors cannot influence a 363(b) transaction as one under Chapter 11, are 363(b) transaction requirements of notice and hearing sufficient enough at least to guarantee creditors sufficient due process?

Second Circuit courts have answered this question in a number of ways, interpreting the provisions of section 363 either alone or in concert with other Code provisions as providing adequate due process for interest holders regarding 363(b) transactions.[85] *Continental Air Lines, Inc.* (*Continental*), for example, seems to suggest that § 363(d) and (e) of the Code might supplement the notice and hearing requirements to ensure adequate due process for addressing a 363(b) transaction.[86] The *Continental* court noted that § 363(d) allows a 363(b) sale "only to the extent not inconsistent with any relief granted under [subsections] 362(c), 362(d), 362(e), or 362(f)," and that § 363(e) provides adequate protection for a party with an interest for any property proposed for a 363(b) transaction.[87]

Calling the notice and hearing requirement the "due process component" of a 363(b) transaction, the bankruptcy court in *Copy Crafters Quickprint, Inc.* (*Copy Crafters*) stated it "serve[ed] as a substitute for the safeguards of disclosure, voting, acceptance, and confirmation were it instead part of a Chapter 11 plan."[88] The *Copy Crafters* court "consider[ed] all salient factors pertaining to the proceeding" to establish this substitutive, or due process, role of the hearing.[89] On the other hand, the lack of such measures as full disclosure requirement and voting under subsection 363(b)'s notice and hearing requirement would not meet due process when conducting a transaction within a Chapter 11 reorganization plan due to the requirements in § 1125 and § 1126: thus, a conundrum exists.[90]

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85. *See, e.g., In re* Lionel Corp., 722 F.2d 1063 (2d Cir. 1983).

86. *In re* Continental Air Lines, 780 F.2d 1223, 1226 (5th Cir. 1986).

87. *Id.* Adequate protection, as defined by section 361 of the Code may be cash payments, additional or replacement liens, or such other relief as to provide "the indubitable equivalent of such entity's interest in such property." 11 U.S.C. § 361(3) (2006); *see also* Sloane, *supra* note 37, at 50 (interpreting the district court decision in *Continental* to allow a 363(b) transaction to show that the requirements of section 363(b) combined with Bankruptcy Rules 2002, 4001, and 9019 were comparable to the Chapter 11 requirements).

88. *In re* Copy Crafters Quickprint, Inc., 92 B.R. 973, 983 (Bankr. N.D.N.Y. 1988).

89. *Id.*; *Lionel Corp.*, 722 F.2d at 1071.

90. *See* 11 U.S.C. § 1125(a), (c) (2006); 11 U.S.C. § 1126(c), (d) (2006); Sloane, *supra* note 37, at 63-64. The Fifth Circuit has suggested,

> "[I]f a debtor were allowed to reorganize the estate in some fundamental fashion pursuant to 363(b), creditor's [sic] rights under, for example 11 U.S.C. 1125, 1126, 1129(a)(7), and 1129(b)(2) might become meaningless. Undertaking reorganization piecemeal pursuant to 363(b) should not deny creditors the

C. *363(b) Transactions: Sub Rosa Plans?*

A *sub rosa* bankruptcy plan describes a debtor-in-possession's 363(b) transaction which deprives secured creditors of "the (Chapter 11) comprehensive protections normally afforded to them in the plan confirmation process."[91] These protections include those such as the aforementioned formal disclosure, an opportunity to vote on the proposed plan, the right to make objections to the plan's distributions, and "a fully noticed confirmation process."[92] In other words, a *sub rosa* plan is a 363(b) transaction that amounts to an end-around of Chapter 11 and thus circumvents the Code's protections for creditors.[93] They are "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 the reorganization plan."[94] One commentator explained a *sub rosa* plan as follows:

> The [Chapter 11] plan process is essentially one of fairness that invites the participation, through negotiation and voting, of all creditors and interest holders. A *sub rosa* plan is a transaction or agreement that commits such a substantial part of the debtor's assets that, if the transaction were allowed, the terms of a plan of reorganization would be severely limited, if not completely predetermined.[95]

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protection they would receive if the proposals were first raised in the reorganization plan."

In re Braniff Airways, Inc., 700 F.2d 935, 939-40, *reh'g denied*, 705 F.2d 450 (5th Cir. 1983).

91. Cademartori & Wolfe, *supra* note 18. *Sub rosa* is Latin for "under the rose," demarcating something intended to be secret or confidential. *See id.*

92. *Id.* Just as the Code provides no standards for the notice and hearing accompanying a proposed 363(b) transaction, neither does it provide any measures a judge might take to modify a proposed transaction determined to be a *sub rosa* plan. The Second Circuit offers some guidance in *Continental*, stating that a bankruptcy court might take "appropriate protective measures modeled on those which would attend a reorganization plan," suggesting a judge could apply the requirements from Chapter 11 to the proposed plan. *Continental*, 780 F.2d at 1228.

93. *Cf.* James Patrick Shea, Candace C. Carlyon & Randon D. Hansen, *Pushing the Limits of Section 363 – Is Confirmation Obsolete in the Asset Sale Case?*, 14 J. BANKR. L. & PRAC. 2 Art. 2 (2005) (categorizing cases which courts found impermissible 363(b) transactions as (1) those that seem to govern the terms of a future reorganization plan ("*sub rosa*"); (2) where the transaction benefited one creditor; (3) where a timeliness rationale is used but not justified; and (4) when bad faith clouds the transaction).

94. *In re* Iridium Operating LLC, 478 F.3d 452, 466 (2d Cir. 2007) (quoting *In re* Braniff, 700 F.2d at 940).

95. Sloane, *supra* note 37, at 45.

When courts reject *sub rosa* claims, they usually do so by finding the proposed transactions to not have a significant enough effect on their respective reorganization plans.[96] As discussed below, rulings on *sub rosa* claims have developed to become the second step of a two-step process to determine the acceptability of a proposed 363(b) transaction.

IV. THE SECOND CIRCUIT'S STANDARD FOR 363(b) TRANSACTIONS

A. *The Lionel Standard: "Sound Business Justification"*

As Second Circuit courts had done in previous cases involving 363(b) transactions, the *Chrysler* bankruptcy court looked to *Lionel*, in which it had articulated its standard on 363(b) transactions, particularly those prior to the acceptance of a Chapter 11 plan.[97] *Lionel* involved an attempt by the Lionel Corporation to sell its interest in an electronic company preconditioned on its Chapter 11 reorganization plan.[98] Lionel owned 82% of the electronic company, which represented 34% of Lionel's assets, making it Lionel's most valuable single asset.[99] Citing § 363(b), Lionel obtained bankruptcy court approval to sell its interest in the electronics company.[100] Similar to *Pension Trust,* in *Chrysler*, Lionel's Committee of Equity Security Holders (Equity Committee), which represented Lionel's public share holders, objected to the sale, asserting its performance before the court's approval of the reorganization plan deprived "the equity holders of the [Code's Chapter 11] safeguards of disclosure, solicitation and acceptance and divest[ed] the debtor of a dominant and profitable asset which could serve as a cornerstone for a sound plan."[101] Evoking the original criteria for 363(b)-type transactions from the Bankruptcy Act of 1938, the Equity Committee took the position that Lionel might only use a 363(b) transaction in extraordinary circumstances ("emergencies"), uncalled for by its reorganization plan.[102] In turn, Lionel cited its

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96. *Id.* at 38. 363(b) transactions are not the only type of outside transaction that potentially undermines Chapter 11. As a New York bankruptcy court noted, "settlement, abandonment of property under [section] 554, or a transaction out of the ordinary course of business under section 1108 raise the concern that the scheme of Chapter 11 will be distorted." *In re* Crowthers McCall Pattern, Inc., 114 B.R. 877, 885 (Bankr. S.D.N.Y. 1990).

97. *In re* Chrysler, 405 B.R. 84, 94 (Bankr. S.D.N.Y. 2009).

98. *In re* Lionel, 722 F.2d 1063, 1064 (2nd Cir. 1983).

99. *Id.* at 1064-65.

100. *Id.* at 1065-66.

101. *Id.* at 1066.

102. *Id.*

Creditors' Committee's insistence on the sale as justification for the action.[103] The Creditors' Committee seemed to view the sale as the major source of cash for repaying over half of Lionel's debt under the reorganization plan and argued that a 363(b) sale was not preconditioned on a Chapter 11 petitioner facing extraordinary circumstances, but rather fell under the purview of bankruptcy courts to use at their discretion.[104]

Borrowing a principal of corporate law, the Second Circuit took a path between the Equity and Creditors' Committees, eschewing the former criteria the Equity Committee called for and reserving the power for bankruptcy judges to determine the viability of subsection 363(b), yet confining them "to articulate sound business justifications . . . other than the appeasement of major creditors" for doing so.[105] Although the court does not mention it, its reasoning hearkens to the business judgment rule. A principal of corporate law, the business judgment rule gives great deference to a company's directors, protecting their decisions in the course of business from potential liability save for those that are obviously incorrect or egregious.[106] The far-ranging application of the rule extends to directors' decisions as debtors in possession in the Chapter 11 process.

The Second Circuit's opinion was in large part a commentary on the changes of Congress's perceptions of 363(b) and its predecessors within the framework of the 1978 Code amendments, which created a measure of uncertainty surrounding the use of 363(b).[107] At least one Ohio bankruptcy court reflected the sense of uncertainty of other courts regarding

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103. *Id.*

104. *Id.*; *see* William T. Bodoh, John W. Kennedy & Joseph P. Mulligan, *The Parameters of the Non-Plan Liquidating Chapter Eleven: Refining the Lionel Standard*, 9 BANKR. DEV. J. 1, 8-17 (1992) (discussing the various conceptions of the good business justification standard of *Lionel*).

105. *Lionel*, 722 F.2d at 1066, 1071. The Second Circuit proposed the following, non exclusive list of factors in assessing potential 363(b) sales: (1) the asset's aggregate value within the bankruptcy estate; (2) the time length between bankruptcy filing and the 363 sale; (3) the possibility that a proposed reorganization plan would be confirmed in a relatively short time period; (4) how the transfer might affect future reorganization plans; (5) the value obtain from the assets' sale compared to their appraised value; (6) whether the 363 sale involves a use, sale, or lease; and (7) the direction of the assets value. *Id.*

106. BLACK'S LAW DICTIONARY (9th ed. 2009) (defining business-judgment rule).

107. Amending the Bankruptcy Act of 1898, the Chandler Act of 1938 allowed for the reorganization of businesses through the liquidation of their assets, thus the practice was common at the time of the Bankruptcy Reform Act of 1978. Bodoh et al., *supra* note 104, at 2-3. These cases, however, usually only allowed this practice under an approved plan, unlike a 363(b) transactions. *Id.* at 3. With the advent of 363(b) transactions following the passage of the 1978 Act, "the lack of creditor safeguards trouble some of the first courts to consider sizable section 363 sales." *Id.* at 4; *see* also Rose, *supra* note 29, at 263-70.

whether or not a Chapter 11 petitioner could use the provision to sell the bulk of its assets outside the bankruptcy plan.[108] Through a review of court decisions on the issue, the court noted that some courts generally allowed the practice, while the more stringent courts only did so in the event of the "emergency" situations, the original criteria.[109] The court also asserted that a review of the legislative history surrounding the genesis and enactment of the Code in 1978 showed that "a [C]hapter 11 reorganization . . . does not authorize the sale of all or substantially all assets of the estate."[110] The Second Circuit has not taken this tact.

The Second Circuit, using the business judgment rule, seems to have used *Lionel* to articulate a more permissible use of 363(b) transactions precluded by the *White Motor* court. This stance allows broad latitude for a bankruptcy judge to approve of these sales within certain bounds by casting the parties' contentions surrounding the proposed sale as straddling the pre- and post-1978 Code modifications on out of court pre-petition sales, and ruling in line with those modifications. Taking a somewhat different view of both legislative and case history of the *White Motor* court, the Second Circuit described prior cases addressing 363(b) transactions and its Code predecessors as using standards based on whether pre-petition assets in question were, as they stated, "perishable" or "deteriorating," and whether the debtor was in an "emergency" state which had created rigorous standards for pre-petition sales.[111] The Second Circuit asserted that the legislative history behind the 1978 revisions, which discarded these terms, did away with these confining standards, evidencing one of Congress' overarching intentions of the Code revisions of giving "equity interests" a "greater voice in reorganization plans."[112] Accordingly, the bankruptcy court, while checked by the stipulation of subsection 363(b) for a notice and hearing on a proposed transaction, should not have been denied the latitude to allow that sale should it promote fairness and equity for the Chapter 11 plan, as previous 363(b) and analogous Code provisions may have done.[113]

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108. *In re* White Motor Corp., 14 B.R. 584, 588 (Bankr. N.D. Ohio 1981); *see* Bodoh et al., *supra* note 104, at 4 (discussing *White Motor* within the context of the history of bankruptcy liquidation sales and as a forerunner to *Lionel*).

109. *White Motor*, 14 B.R. at 588-89.

110. *Id.* at 589-90.

111. *In re* Lionel Corp., 722 F.2d 1063, 1067-69 (2d Cir. 1983).

112. *Id.* at 1070-71.

113. *Id.* at 1069. The Second Circuit indirectly asserted a bankruptcy judge's authority in *Lionel*. Citing the broad power afforded the bankruptcy judge in subsection

The Second Circuit ultimately held that the Creditors' Committee's insistence, did not meet the "good business justification" threshold for Lionel's proposed 363(b) sale because it was not a "sound business reason," and "ignor[ed] the equity interests required to be weighed and considered under Chapter 11."[114] The Second Circuit justified its holding by describing the electronic company's stock as performing well, which undermined need for a quick sale because the stock was not a "wasting asset."[115] The Second Circuit noted the bidders would have been just as interested in the stock six months beyond the proposed purchase period, indicating a potentially higher purchase price.[116] Thus the premature nature of the proposed 363(b) transaction would have cut against the Code's guiding principles of fairness and equity.[117]

105(a) of the Code, the Second Circuit repeated its stance that a bankruptcy judge should have wide latitude "to tailor his orders to meet differing circumstances when deciding on whether a Chapter 11 commercial debtor could reject an unexpired commercial lease retroactively." Adelphia Bus. Solutions v. Abnos, 482 F.3d 602, 603, 609-10 (2d Cir. 2007); *see* Bodoh et al., *supra* note 104, at 17-18 ("The flexibility of the *Lionel* standard is appropriate because, as this survey illustrates, sales of substantial assets arise in an infinite variety of bankruptcy situations, and the justifications for permitting a [debtor in possession] to conduct such sales are equally as diverse. The Lionel standard is a beneficial rule that embodies the flexibility intended by the [Code]."). Ironically, while *Lionel* might have afforded a judge more latitude in one aspect, one of the effects of the 1978 Code implementation was to take authority away from judges. *See, e.g.*, Kuney, *supra* note 46, at 26-29 (explaining that where bankruptcy judges had administered cases before the 1978 amendment the United States Trustee and unsecured creditors' committees did so afterward, and providing a short overview of the effects of the 1978 Code implementation of the bankruptcy process).

114. *Lionel*, 722 F.2d at 1071. The Fifth, Sixth, Eighth, and Ninth Circuits have embraced the *Lionel* standard. *See In re* Continental Air Lines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986) ("We also agree with the Second Circuit that implicit in 363(b) is the further requirement of justifying the proposed transaction . . . there must be some articulated business justification . . . ."); Stephens Ind., Inc. v. McClung, 789 F.2d 386, 390 (6th Cir. 1986) ("We adopt the Second Circuit's reasoning in *In re Lionel Corporation*[:] . . . a bankruptcy court can authorize a sale of all a Chapter 11 debtor's assets under 363(b)(1) when a sound business purpose dictates such action."); *In re* Food Barn Stores, Inc., 107 F.3d 558, 564 (8th Cir. 1997) (adopting the *Lionel* rational that a "bankruptcy judge must not be shackled with unnecessary rigid rules when ruling on a proposed 363 sale"); *In re* 240 North Brand Partners, Ltd., 200 B.R. 653, 659 (9th Cir. BAP 1996) ("[D]ebtors who wish to dispose of the bankruptcy estate must demonstrate that such disposition has a valid business justification.").

115. *Lionel*, 722 F.2d at 1069.

116. *Id.* at 1072.

117. *See In re* Chateaugay Corp., 973 F.2d 141 (2d Cir. 1992), for a foil to *Lionel* within the Second Circuit in terms of what assets might meet the good business reasons standard. In that case, a Chapter 11 pre-petitioning corporation sought to make a 363(b) sale of the assets of a subsidiary to multiple entities. *Id.* at 143. The unsecured creditors' committee of that subsidiary objected to the sale in large part because it sought a separate Chapter 11 reorganization independent of its parent company. *Id.* In affirming the district judge's allowance of the sales, the Second Circuit stated the district judge applied the *Lionel* standard correctly, citing the deprecating value of the assets, the

B. *The* Lionel *Legacy*

Following the *Lionel* decision, Second Circuit bankruptcy courts used the "sound business justification" standard when ruling on 363(b) transactions.[118] While this standard is certainly broad enough to allow courts latitude in their rulings, it may not be so for 363(b) transactions involving the sale of substantially all of a debtor's assets. In *Lionel*, the Second Circuit addressed the transfer of one portion of Lionel's assets, albeit the largest.[119] However, as mentioned, 363(b) transactions may essentially amount to liquidation sales, such as the case of the Chrysler bankruptcy. Would the sound business reasoning standard still hold when a Chapter 11 debtor attempts to change dramatically the nature of its operations through the sale of its assets?

Another Second Circuit bankruptcy case, *Oneida Lake Development, Inc.* (*Oneida Lake*),[120] addressed this issue. Much like *Chrysler*, this case involved a Chapter 11 debtor's attempt to sell its real estate, which represented virtually all of its assets, under subsection 363(b) upon the objection of two judgment creditors and a lender.[121] Noting that the transaction here differed from that in *Lionel* because it involved all of the Chapter 11 debtor's assets, the bankruptcy court maintained the *Lionel* standard while discarding a number of the factors the *Lionel* court offered in analyzing a proposed 363(b) sale.[122] In allowing the transfer to proceed, the court determined the most relevant factors to be the length of time between the proposed sale and the bankruptcy filing, the difference in the transfer's sales value and the asset's appraised value, and the fluctuations in the asset's value – all factors which portend the *Chrysler* decision.[123] However, the *Oneida Lake* court failed to address the

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possible decline in the subsidiary's industry, and the fact that the subsidiary could not receive a better offer than from the purchasing entities. *Id.* at 143-44.

118. *See, e.g.*, *Continental*, 780 F.2d at 1277 ("conclud[ing] that the district court did not err in affirming the bankruptcy court finding that the business justifications CAL offered in support of the leases are sufficient to authorize proceeding with lease negotiations"). Using the *Lionel* standard, courts outside the Second Circuit have also allowed 363(b) transactions for "an array of articulated business justifications," which often involve the debtor justifying a plan because it would save "time and/or money" and thus "maximize value for the estate." Rose, *supra* note 29, at 269; *see, e.g. Copy Crafters*, 92 B.R. 973, 982 (Bankr. N.D.N.Y 1988) (allowing the transaction "if the trustee could not operate the business at a profit and operations were about to cease because the business could not meet its expenses") (citing *Stephens Ind.*, 789 F.2d at 390).

119. *Lionel*, 722 F.2d at 1065 ("Lionel's most important asset and the subject of this proceeding is its ownership of 82% of the common stock of Dale . . . .").

120. *In re* Oneida Lake Dev., Inc., 114 B.R. 352 (1990) (Bankr. N.D.N.Y. 1990).

121. *Id.* at 353.

122. *Id.* at 355.

123. *Id.*

implications behind the nature of the 363(b) transaction as the court in *Chrysler* did. That is, it did not discuss how the sale would affect creditor priorities within the Chapter 11 reorganization scheme.

One of the most salient functions of Chapter 11 is the reallocation of a debtor's assets within a framework aimed at ensuring equity and fairness for all parties involved.[124] Would the allowance of a 363(b) sale of all of a Chapter 11 debtor's assets - a transaction outside the Chapter 11 framework - essentially undermine one of the reasons for seeking a Chapter 11 reorganization and thus amount to *sub rosa* plan? The Second Circuit addressed this question through the lens of *Lionel* and the Fifth Circuit's decision in *Braniff Airways, Inc.*[125]

C. Braniff *and the Sub Rosa Plan*

As indicated, *Braniff* may be viewed as the second step to *Lionel* in evaluating a 363(b) transaction.[126] It is the seminal case on 363 *sub rosa* plans because it introduced the term and articulated the idea of using 363(b) transactions to side-step Chapter 11 requirements.[127] In a sense, it addresses the unanswered Equity Committee's objections to the 363(b) sale in *Lionel* as an avoidance of Chapter 11's protections to creditors.[128] In *Braniff*, Braniff Airways, a corporation seeking Chapter 11 reorganization, attempted a transfer with another company involving travel scrip, operating assets, and rights under a 363(b) sale.[129] The Fifth Circuit found the transaction to be "much more than the 'use, sale or lease' of Braniff's property authorized by 363(b)" because it determined the terms of whatever future reorganization plan Braniff might undertake, subordinated secured creditors to unsecured creditors in approving a plan, and required Braniff's release from all claims.[130] The Fifth Circuit, in other words, essentially stated that the transaction constituted a *sub rosa* plan because its stipulations dictated the terms of a future reorganization plan, limited creditor voting within that

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124. *See supra* note 93 and accompanying text.

125. *In re* Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983). Ironically, the Fifth Circuit in *Braniff* does not answer whether a debtor could sell all its assets under subsection 363(b). *Id.* at 939. However, following *Braniff*, the Fifth Circuit in *Richmond Leasing Co. v. Captial Bank, N.A.* strongly suggests a debtor could do so. 762 F.2d 1303, 1311-12 n. 10 (5th Cir. 1985).

126. *See* Rose, *supra* note 29, at 265.

127. *Braniff*, 700 F.2d at 940.

128. *In re* Lionel, 722 F.2d 1063, 1066 (2d Cir. 1983).

129. *Braniff*, 700 F.2d at 938-39.

130. *Id.* at 939-40.

plan, and changed creditors rights toward the debtor, all working to circumvent the required Chapter 11 measures that a plan must meet prior to its approval.[131]

The Fifth Circuit combined *Braniff* and the *Lionel* standard to create a two-step process to analyze 363(b) plans that the Second Circuit adopted in *Chrysler*.[132] Hence, a court might still reject proposed 363(b) transactions which meet the *Lionel* good business justification threshold. The example par excellence might be found in *Continental*.[133] Here, the Fifth Circuit called into question a Chapter 11 debtor's 363(b) transfer proposal to rent two aircrafts.[134] The Fifth Circuit admitted that leasing the aircrafts would improve the debtor's business, which would in turn increase the probability the debtor would perform on its eventual reorganization plan.[135] However, it denied the proposal due to the plan's ultimate effect on creditors' rights.[136] The Fifth Circuit cited its decision in *Braniff* that a debtor proposing a 363(b) transaction could not "sidestep the protection creditors have when it comes time to confirm a plan of reorganization."[137] The court also echoed a danger that its effects might change the make-up of the debtor's estate in such a way that would deny creditors' rights guaranteed in the eventual reorganization plan (thus its description as "creeping plan[s] of reorganization" which would "stretch the bankruptcy laws to undertake transactions outside a plan of reorganization)."[138] In addressing the 363(b) transfer's effect, the Fifth Circuit in *Continental* (like in *Braniff*)

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131. *Id.* at 940. *See* Sloane, *supra* note 37, at 46-47 (contending that the three reasons the *Braniff* court gave for ruling the 363(b) transaction a *sub rosa* plan "became factors that many other courts would later rely on" in their analysis of similar transactions). A *sub rosa* claim could not exist if the transaction in question is within a Chapter 11 plan or contingent on the approval of a reorganization plan. *See, e.g., In re* Ionosphere Clubs, Inc., 184 B.R. 648, 654 (Bankr. S.D.N.Y. 1995); Bartel v. Bar Harbor Airways, Inc., 196 B.R. 268, 273 (Bankr. S.D.N.Y. 1996); *In re* Crowthers McCall Pattern, Inc. 114 B.R. 877 (Bankr. S.D.N.Y. 1990).

132. *See In re* Chrysler, 576 F.3d 108, 117-18 (2d Cir. 2009).

133. *In re* Continental Air Lines, Inc., 780 F.2d 1223 (5th Cir. 1986).

134. *Id.* at 1224.

135. *Id.* at 1227.

136. *Id.* at 1227-28.

137. *Id.* at 1227.

138. *Id.* at 1224, 1227-28; *see* Sloane, *supra* note 37, at 54-55 (discussing *sub rosa* claims involving settlement agreements and focusing on the Fifth Circuit decision in In re *Cajun Electrical Power Cooperation, Inc.*, 119 F.3d 349 (5th Cir. 1997), in which the court allowed a suit settlement under 363(b) and noted how the Fifth Circuit analyzed the case's facts through the lens of the effects of the *Braniff* court's articulation of *sub rosa* plan to arrive at its conclusion). Sloane further observes that 363(b) *sub rosa* claims involving settlements differ from those involving standard transaction because the bankruptcy court must consider not only how the settlement might affect a future reorganization plan, but also if the plan comports with Bankruptcy Rule 9019. *Id.* at 55.

focused on the *sub rosa* implications in analyzing 363(b) transactions that the Second Circuit did not do so in *Lionel*.[139]

D. *The Second Circuit and* Braniff

Second Circuit courts have embraced half-heartedly the *Braniff* rationale as the second step of the two-step process in determining if 363(b) transactions constituted *sub rosa* plans.[140] In re *Iridium Operating, L.L.C.*[141] (*Iridium*) was the first case in which the Second Circuit directly addressed a *sub rosa* plan accusation within the context of a Chapter 11 reorganization, but did so in only a limited manner.[142] In *Iridium*, Motorola, a former parent company and first-priority creditor of Chapter 11 pre-petitioner Iridium, opposed Iridium's 363(b) sale of its assets claiming in part that it was a *sub rosa* sale.[143] The *Iridium* court cited the "sound business reason" of *Lionel* as its guidelines for determining Motorola's claim and concluded that one existed for the judge to allow Iridium's settlement, thus defeating Motorola's *sub rosa* claim.[144] The Second Circuit concluded that Iridium met the *Lionel* threshold because the sale of its assets, as the hallmark of a 363 sale, would result in the dissolution of all of their associated liens and ultimately facilitate Iridium's ability to perform its eventual Chapter 11 plan, a tack the *Chrysler* court would take.[145] The Second Circuit mentioned *Braniff*, but confined itself to *Lionel* in its holding.[146]

Second Circuit courts have, however, applied the *Braniff* rationale, particularly to proposed 363(b) transactions similar to that in *Braniff*.[147] For example, a New York bankruptcy court found a *sub rosa* plan to exist where the proposed 363(b) transaction, a lease, would have effected a portion of a proposed plan without the Chapter 11 requirements.[148] Without notifying the court, the Chapter 11 debtor leased its assets to a former

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139. *Continental*, 780 F.2d at 1226.

140. No other Courts of Appeals beyond the Second and Fifth Circuits appear to embrace the *Lionel-Braniff* rationale.

141. *In re* Iridium Operating, LLC, 478 F.3d 452, 466-67 (2d Cir. 2007).

142. *Id.*

143. *Id.* at 466.

144. *Id.*; *see also In re* Lionel, 722 F.2d at 1071 (adopting a rule requiring a judicial finding of a "sound business reason" to grant a § 363(b) application).

145. *Iridium*, 478 F.3d at 467.

146. *Id.* at 466.

147. *See In re* Copy Crafters Quickprint, Inc., 92 B.R. 973, 982 (Bankr. N.D.N.Y. 1988).

148. *Id.*

employee in exchange for payments.[149] The debtor then sought court approval for the lease under 363(b), with the eventual sale of the debtor's assets to the former employee being part of the proposed reorganization plan.[150] The court held that the lease transaction should have been conducted pursuant to its authority under 363(b), and not to allow so "would render the due process safeguard of [363(b)(1)] a casualty."[151] Thus, the court took the most prevalent view throughout the Second Circuit that the notice and hearing requirements are sufficient to establish due process for a 363(b) transaction.[152] Citing *Lionel* and *Braniff*, the court found the debtor did not provide sufficient good business reasons.[153] The court further held the lease could not be made under subsection 363(b) because it amounted to a forced transition to the sale, which was under the proposed reorganization plan, and thus to allow it would essentially "bootstrap" the sale and "put the Court's imprimatur on [it] and confirm the plan long before the hurdles of Chapter 11 [were] overcome."[154] The ruling of *Copy Crafters* is consistent with another Second Circuit bankruptcy court's ruling on a settlement under subsection 363(b) between two secured creditors of a Chapter 11 debtor.[155] Applying *Braniff*, the court in *Lion Capital Group* reasoned that the terms of the settlement were confined to the contending parties, and thus did not amount to a *sub rosa* plan.[156] The court explained that one of the terms at issue in the settlement, the subordination of one of the parties' claims to another, should not be considered a circumvention of a Chapter 11 plan because it "would not unfairly discriminate against other creditors or provide for impermissible (Chapter 11) classifications."[157] This rationale presages *Chrysler*.

V. THE CHRYSLER BANKRUPTCY

A. *Chrysler and the Lionel Standard*

Unlike the scenario in *Lionel*, the Chrysler bankruptcy involved substantially all of Chrysler's assets, thus placing it

149. *Id.* at 977-78.
150. *Id.* at 984.
151. *Id.*
152. *Id.*
153. *Id. at* 982-83.
154. *Id.*
155. *See In re* Lion Capital Group, 49 B.R. 163 (Bankr. S.D.N.Y. 1985).
156. *Id.* at 176-78.
157. *Id.* at 177-78.

more in line with *Oneida Lake*.[158] The Second Circuit viewed the proposed sale of Chrysler assets under § 363(b) to meet the *Lionel* threshold for four reasons.[159] First, unlike the sale of the electronic company's stock in *Lionel* which had multiple bidders, Fiat was the sole bidder for Chrysler's stock, rendering Chrysler with limited options.[160] Second, potential benefits existed between Chrysler and Fiat integration: Chrysler had a preexisting set of dealership and production capabilities, while Fiat provided smaller-car technology and increased access to international markets.[161] Third, a time element demanded a quick sale.[162] Whereas Lionel admitted its stock in the electric company could have been sold six months from the Chapter 11 pre-petition period, Chrysler ceased operations prior to its reorganization, translating into increased losses in sales, costs, workers, and the like.[163] Moreover, the United States and Canadian governments demanded that their financing offer to Chrysler be contingent upon a quick sale and allowed Fiat to withdraw its purchase offer should a sale not occur by June 15, 2009 — a short six-week time frame from Chrysler's Chapter 11 petition.[164] Fourth, failure of the sale would have undermined Chrysler's reorganization, which would have led to the Chapter 11 plan being converted to a Chapter 7 liquidation plan, resulting in a near systemic halting of Chrysler's operations.[165] Chrysler essentially needed cash to meet its future Chapter 11 payment obligations.[166]

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158. *In re* Oneida Lake Dev., 114 B.R. 352 (Bankr. N.D.N.Y. 1990).

159. *In re* Chrysler, 405 B.R. 84, 95 (Bankr. S.D.N.Y. 2009).

160. *Id.*

161. *Id.* at 95-96.

162. *Id.* at 96.

163. *See id.* at 96; *In re* Lionel, 722 F.2d 1063, 1072 (2d Cir. 1983).

164. *Chrysler*, 405 B.R. at 96-97.

165. *Id.* at 97. Subsection 1112(a) of the Code allows a debtor to convert a case under any chapter to Chapter 7. 11. U.S.C. § 1112(a) (2006). Conversely, subsection 706(a) allows the conversion of a Chapter 7 case to any other chapter. 11 U.S.C. § 706(a) (2006).

166. Sufficient funds to fulfill a Chapter 11 plan stave off potential heavy handed tactics by creditors. Debtors often need financing to meet the benchmarks of their Chapter 11 reorganization plans, which allows potential creditors the opportunity, should they desire to take the risk, to obtain a significant amount of control of the debtor as it moves through the bankruptcy process. Given the perilous state of the Chapter 11 debtor's business and subsequent risk of total collapse, the amount of consideration lenders would require is substantial; hence, these types of loans are often high-interest, short-term (usually the length of the bankruptcy performance period), and carry conditions that prioritize their liens over more senior liens. Kuney, *supra* note 46, at 46-51. Courts might allow these loans if the debtor has no other recourse to funds. *Id.* at 48. The debtor would obviously prefer an unsecured source of funding, but entities willing to fund a Chapter 11 debtor on an unsecured basis are few and far between. *Id.* at 47-48. Hence, a bankruptcy judge might grant these overriding types of secured loans. *Id.* at 48.

In further justifying its decision, the bankruptcy court added that, unlike in *Lionel*, there was widespread support for this 363(b) transaction: the auto unions, Creditors Committee, and "almost all other stakeholders" supported the sale.[167]

B. *Chrysler's Sub Rosa Claim*

Citing *Braniff*, the bankruptcy court in *Chrysler* asserted the proposed 363(b) transaction was not a *sub rosa* plan because Old Chrysler would receive more than fair value in return for the sale of assets to Fiat, and all the sales proceeds would be distributed according to the Chapter 11 priority scheme.[168] The court noted that Fiat was the only entity willing to help Chrysler, unlike the situation in *Lionel* with multiple bids for the electric company, and that should it nullify the transaction, Chrysler would be forced into a total liquidation.[169] The court further found that Pension Trust misapplied the holding of *Westpoint*.[170] The court distinguished Chrysler's 363(b) transaction in stating that its sales proceeds would go directly to Chrysler's creditors according to the Chapter 11 requirements, not outside it as in *Westpoint*.[171]

Indeed, the bankruptcy court's theme in justifying its holding was that the transaction in no way affected the Chapter 11 priority scheme.[172] The court stated that the executory contracts New Chrysler would take over through the sale did not violate the priority rules of a Chapter 11 plan, even though they received more favorable treatment than other creditors in the same class or in a higher class.[173] In the same vein, the court noted that New Chrysler's assumption of particular contracts it desired as part of the transaction became obligations for New Chrysler, not a subtraction from Chrysler's bankruptcy estate.[174] This apparently means that Chrysler maintained obligations under those contracts despite transferring them to New Chrysler. Finally, and most salient, the court stated that the allocation of

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167. *Chrysler*, 405 B.R. at 97.

168. *Id.* at 97-98. A valuation determination of Chrysler's assets if liquidated was 800 million dollars, but as stated *supra*, Fiat purchased the assets for two billion dollars. *Id.* at 97.

169. *Id.* at 98; *In re* Lionel, 722 F.2d 1063, 1065 (2d Cir. 1983).

170. *Chrysler*, 405 B.R. at 98. As mentioned above, *Westpoint* was a case involving an attempted 363(b) transaction consisting of a sale of a debtor's assets directing the proceeds to secured creditors in order to satisfy their security interests and fulfill their claims – a process exclusively under the purview of Chapter 11. *Id.*; Contrarian Funds, LLC v. Westpoint Stevens, Inc., 333 B.R. 30 (Bankr. S.D.N.Y. 2005).

171. *Chrysler*, 405 B.R. at 98.

172. *Id.* at 95-96, 99.

173. *Id.* at 98-99.

174. *Id.* at 99 n.18.

the purchased assets did not translate to a *sub rosa* plan because what New Chrysler did with those assets had no bearing on Chrysler's bankruptcy estate.[175] Moreover, the court suggested the short time frame Chrysler had to cement the transaction with Fiat did not undermine the due process element of the sale.[176] Finding the notice and hearing requirement sufficient, the court reasoned that the well publicized nature of the sale and high profile scrutiny of Chrysler's operations ensured a thorough review of the transaction sufficiently fair to all interested parties.[177]

C. *The Significance of Chrysler's 363(b) Transaction*

At the time of its hearing, *Chrysler* possibly constituted the most significant Second Circuit case involving a 363(b) transaction. Beyond its economic significance, it afforded a spotlight by which the Second Circuit could articulate a position on the sale of virtually all a debtor's assets outside a Chapter 11 plan.[178] Beyond explaining the economic need for Chrysler's existence, the bankruptcy court inculcated the preservation of the Chapter 11 priority scheme as its guiding principle.[179] The court essentially narrowed the focus of what constituted a standard Chapter 11 bankruptcy plan.[180] The question of how to allocate assets to fulfill the reorganization scheme was truncated to focus only on how to fulfill the scheme.[181] The preservation of the Chapter 11 priority scheme is dispositive in determining whether a 363(b) transaction is a *sub rosa* plan.[182] In other words, a creditor who objects to a 363(b) sale would only be successful if he showed either the transaction altered its place in the debtor's Chapter 11 plan, the transaction fulfilled an obligation to a creditor within the plan, or both.[183] The subsection 363(b) notice and hearing requirement to satisfy due process then appears somewhat more acceptable because it only would involve creditors' interests, not the allocation of the debtor's assets.[184] Unfortunately, the bankruptcy court, Second Circuit, and the Supreme Court did not offer any standards on

175. *Id.* at 100.
176. *Id.* at 109.
177. *Id.*
178. *Id.* at 95-100.
179. *Id.*
180. *Id.*
181. *Id.*
182. *Id.* at 97-98.
183. *Id.*
184. *Id. at* 109.

ascertaining a proper 363(b) transaction. Perhaps like the *Lionel* court stated, the uniqueness of each Chapter 11 case precludes the application of hard and fast guidelines.[185]

D. *The Chrysler Effect – The General Motors Bankruptcy*

In June 2009, the same bankruptcy court which heard *Chrysler* allowed a 363(b) transaction conducted by General Motors (GM), another faltering giant of the auto industry who filed for Chapter 11 bankruptcy after government-sponsored attempts to rejuvenate its business failed.[186] GM's reorganization and 363(b) transaction is a counterpart to that of Chrysler: it would not be an exaggeration to state the Chrysler decision in large part possibly dictated the structure of the 363(b) transaction. Following government-sponsored attempts to restructure out of court, GM struck an agreement for the transaction, where it would sell most of its assets to Vehicle Acquisitions Holdings LLC, or "New GM," a government-sponsored purchaser, as well as assign health and welfare benefits of GM's employees through an agreement with the UAW.[187] Like the Chrysler plan, the U.S. and Canadian Governments were the only entities willing to extend financing for the transaction, subject to a six-week time frame after which they would rescind their offer.[188] Whereas in *Chrysler*, Petitioners Trust was a secured creditor, the objecting party in In re *General Motors, Corp.* (*General Motors*) was a group of bondholders (Bondholders) of unsecured debt, who have inferior rights to secured creditors in a bankruptcy plan. [189]

Part policy and part case law driven, the *General Motors* court's decision relied heavily on *Chrysler*, asserting that its decision disallowing the 363(b) transaction would result in the liquidation, and hence death, of GM, which would have systemic repercussions throughout the auto industry and economy.[190] Indeed, liquidation would preclude the Chapter 11 process aimed

185. *In re* Lionel, 722 F.2d 1063, 1070-71 (2d Cir. 1983). The value Chrysler received for its assets appears a significant factor in determining the acceptability of the 363(b) transaction, although the bankruptcy court did not state as much. That Chrysler received more than twice the value for the in-business-use sale of its assets as opposed to a liquidation sale translates into more cash and thus raises the possibility Chrysler could meet its claims in its eventual Chapter 11 plan. *Chrysler*, 405 B.R. at 97-98.

186. *In re* General Motors, Corp., 407 B.R. 463 (Bankr. S.D.N.Y. 2009), *stay denied*, No. M 47 (LAK) 2009 WL 2033079 (S.D.N.Y. Jul. 09, 2009).

187. *Id.* at 473, 481.

188. *Id.* at 478-79, 480-81.

189. *Id.* at 488 n.21. The Bondholders' claim was even less scant than that of Pension Trust, amounting to .01% total of GM's bonds. *Id.* at 473.

190. *Id.* at 473, 491-93.

at reorganization, rather than selling and paying out creditors.[191] The court was quick to note that GM's creditors would suffer as well.[192] A liquidation sale would produce between six and ten billion dollars value for GM's assets,[193] considerably less than the 45 billion dollars for the 363(b) transaction for creditors to receive in the Chapter 11 distributions.[194] The court enumerated a number of reasons justifying the immediate need for the transaction as a good business decision to satisfy the *Lionel* standard: the avoidance of the costs of a lengthy Chapter 11 process, cutting the losses of GM's plummeting value, the governments' requirement of the sale being under subsection 363(b), the governments' narrowing time frame for offering to sponsor the sale, an expedited sale, the maximization of GM's value, and the looming effects of a liquidation bankruptcy.[195] Responding to the Bondholders' accusation that the sale would short-change creditors, a similar argument of Pension Trust in *Chrysler*, the court noted the sale would provide GM with 45 billion dollars in cash which would be allotted to creditors according to the Chapter 11 priority scheme, vice the value of its liquidated assets, which were estimated between six and 10 billion dollars.[196]

Echoing *Chrysler*, the court added that the GM sale would produce none of the factors articulated in *Braniff* because the sale did not restructure creditor rights in the context of a Chapter 11 plan; rather, the sale injected cash into GM that would be allocated to creditors based on GM's priority list within its eventual, accepted Chapter 11 plan.[197] Addressing an issue not taken up by the *Chrysler* court, the *General Motors* court suggested that a *sub rosa* plan might be implicated if New GM assumed all of GM's liabilities, obviously because that would lead to a restructuring of creditor priority from that under GM's Chapter 11 plan.[198]

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191. *See id.* at 481 (discussing the fact that the one alternative to a § 363(b) would be a liquidation of the company).

192. *Id.* at 474, 481.

193. *Id.*

194. *Id.* at 482, 485.

195. *See id.* at 491-93. The court obliquely referred to its broad grant of power under subsection 105(a) of the Code to assert that Bankruptcy courts have "the power to authorize sales of assets at a time when there still is value to preserve-to prevent the death of the patient on the operating table." *Id.* at 474. The bankruptcy judge seems to derive his decision in large part on the latitude afforded to judges by the Second Circuit in *Lionel*. *See id.* at 387 (noting the importance of decisions such as *Lionel*).

196. *Id.* at 481-82.

197. *Id.* at 474-75, 495-96.

198. *Id.* at 496.

VI. CONCLUSION

The benefits of the 363(b) transaction of Chrysler are palpable. It injected Chrysler with an influx of cash necessary to allow the auto manufacturer to stagger toward bankruptcy and finance the process, buttressed the faltering auto industry, and allowed Chrysler to reconstitute itself, thus providing hope for its future. On the other hand, the 363(b) transaction raised the specter of a company taking advantage of a loophole of ambiguity within the Code to keep its creditors from having any say in how it allocates its assets—a fundamental guarantee of the Chapter 11 process.[199] Second Circuit bankruptcy cases, as embodied in *Chrysler*, seem to adopt a loose *Braniff* standard and allow 363(b) transactions unless they undoubtedly restructure priority schemes within Chapter 11.[200] Given the Supreme Court's allowance of the Chrysler transaction and the ensuing GM case, one should not be surprised if similar transactions are attempted and allowed, particularly if the debtor constitutes a major entity in a particular industry.

Frustratingly, as mentioned, no court has offered fixed guidelines on how to approach 363(b) transactions. Guidelines might prove appropriate, as they would impose some strictures on the already broad powers a bankruptcy judge has under subsection 105(a) of the Code to address 363(b) transactions,[201] and thus curtail a judge's power just as the Chapter 11 requirements do. Perhaps the issues surrounding 363(b) transactions that emerged in the Chrysler bankruptcy, GM bankruptcy, and possibly in future, similar bankruptcies, will drive the Supreme Court to provide courts with a few set standards through which they can analyze these transactions for

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199. *Sloane*, *supra* note 37, at 63-64.

200. A recent bankruptcy case in the Second Circuit's jurisdiction to address a *sub rosa* claim occurred in the same court that heard *Chrysler*. *In re* Global Vision Products, Inc., Nos. 07 Cv. 12628(RDD), 09 Cv. 374(BSJ), 2009 WL 217025 (S.D.N.Y. Jul.14, 2009). The 363(b) transaction in question involved the settlement of a false and misleading advertising claim by a Chapter 11 debtor with class-action plaintiffs. *Id.* at *1. The *sub rosa* claim focused on the terms of the settlement, which required the plaintiffs to subordinate their claims to all general unsecured claims under the plan, a lifting of the automatic stay to allow the plaintiffs to sue individuals associated with the debtor, the debtor to transfer its claims against the individuals to the plaintiffs, the debtor's trustee file a reorganization plan, and the debtor stop sales of the product that was the subject of the plaintiffs' suit. *Id.* at *2. Similar to the *Chrysler* ruling, the bankruptcy court found the settlement to not be a *sub rosa* plan because it did not "dictate the terms of a future plan; rather, it provide[d] for an undertaking by the Trustee to propose a type of plan" while creditors could propose plans as well. *Id.* at *7. The court added that the settlement did not restrict any creditor rights and only bound the debtor and plaintiffs in terms of the lawsuit. *Id.*

201. 11 U.S.C. § 105(a) (2006).

sub rosa plans. Given factors such as the saliency of the auto industry in American business, one wonders why the Supreme Court did not offer an extended opinion on the Chrysler bankruptcy, regardless of the time sensitive nature of the proposed sale. Indeed, in a similar vein, a Southern District of Texas bankruptcy court all but begs the Fifth Circuit to provide more concrete guidelines, and goes to great lengths in its conclusion to explicate certain issues a court can address when determining whether to approve a 363(b) transaction.[202]

Perhaps the contention in the Chrysler bankruptcy, and those surrounding all 363(b) transactions for that matter, are aspects of the over arching debate on the effects of the Code since its inception in 1978.[203] Namely, do the social, commercial, and economic benefits the Code confers on a debtor in terms of resuscitating its business outstrip the costs to creditors and other interest holders?[204] Ironically, the Chrysler bankruptcy recalls the origins of reorganization law, which emerged during the Great Depression as a means of buoying businesses.[205] In that light, the aims of Chrysler's 363(b) transaction could simply be an instance of history repeating itself.

Morris A. Karam

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202. *In re* Gulf Coast Oil Corp., 404 B.R. 407, 422-27 (Bankr. S.D. Tex. 2009). The court offers the Fifth Circuit 13 factors to consider when deciding whether to accept a 363(b) transaction. *Id.*

203. *See* Kuney, *supra* note 46, at 21 (discussing the fact that the Bankruptcy Code was enacted in 1978).

204. *Id.* at 21-22.

205. *See* Bodoh et al., *supra* note 104, at 2-4 (discussing the origins of "Reorganization Cases").