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## Bankrupting Bankruptcy: Circumventing Chapter 11 Protections Through Manipulation of the Business Justification Standard in § 363 Asset Sales, and a Refined Standard to Safeguard Against Abuse

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NOTES

BANKRUPTING BANKRUPTCY: CIRCUMVENTING  
CHAPTER 11 PROTECTIONS THROUGH MANIPULATION  
OF THE BUSINESS JUSTIFICATION STANDARD IN § 363  
ASSET SALES, AND A REFINED STANDARD TO  
SAFEGUARD AGAINST ABUSE

*Kimon Korres*\*

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\* Thank you to my family for all of your love, support, guidance and patience. “If you can fill the unforgiving minute/ With sixty seconds’ worth of distance run/ Yours is the Earth and everything that’s in it/ And—which is more—you’ll be a Man, my Son!”—Rudyard Kipling, *If*.

## I. INTRODUCTION

Of the twenty largest public company bankruptcy filings from 1980 to the present, seventeen have taken place since 2001, and ten of those seventeen were filed between March of 2007 and August of 2009.<sup>1</sup> One such example is *In re Chrysler LLC*, in which Chrysler, on April 30, 2009, filed for protection under Title 11 of the United States Code.<sup>2</sup> For the twelve-month period ending on December 31, 2008, the Chrysler companies suffered a staggering \$16.8 billion loss.<sup>3</sup> The failure of such large companies and the distribution of their enormous wealth of assets have and will continue to have major repercussions.<sup>4</sup> The Bankruptcy Code provides these massive businesses with different options for filing bankruptcy, and these options have reverberating economic and societal effects well beyond any one company's interests. It is thus essential to understand the options provided by the Bankruptcy Code and to ensure they provide for the most advantageous possible outcomes when America's foundational businesses collapse.

While Chapter 11 of the Bankruptcy Code is the traditional guide for corporate reorganization and the payment of creditors over time,<sup>5</sup> Chrysler—following the current corporate trend—chose to proceed pursuant to § 363.<sup>6</sup> Section 363(b) of the Bankruptcy Code authorizes a Chapter 11 debtor-in-possession, such as Chrysler, to “use, sell, or lease” estate property outside the ordinary course of business.<sup>7</sup> Section 363 sales tend to be cheaper and more time efficient than reorganization alternatives.<sup>8</sup> Accordingly, in the last twenty-five years, § 363(b) asset sales have become standard practice in large corporate bankruptcies.<sup>9</sup> “Proponents of the Chapter 11 liquidation method into which § 363 has evolved extol the speed, efficiency, and competition involved in the sales as indications of its superiority over a more traditional reorganization.”<sup>10</sup>

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1. 20 Largest Public Company Bankruptcy Filings 1980 — Present, BANKRUPTCYDATA.COM, [http://www.bankruptcydata.com/Research/Largest\\_Overall\\_All-Time.pdf](http://www.bankruptcydata.com/Research/Largest_Overall_All-Time.pdf) (last visited Apr. 6, 2011).

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

3. *Id.* at 89.

4. *Corporate Bankruptcy & the Wall Street Bailout*, TOTALBANKRUPTCY.COM, <http://www.totalbankruptcy.com/news/articles/miscellaneous/wall-street-bailout-and-corporate-bankruptcies.aspx> (last visited Mar. 3, 2011).

5. *Chapter 11: Reorganization Under the Bankruptcy Code*, U.S. COURTS, <http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter11.html> (last visited Feb. 20, 2011).

6. 405 B.R. at 87.

7. 11 U.S.C. § 363(b)(1) (2006).

8. George W. Kuney, *Let's Make It Official: Adding an Explicit Preplan Sale Process as an Alternative Exit from Bankruptcy*, 40 Hous. L. Rev. 1265, 1273 (2004).

9. *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 576 F.3d 108, 115 (2d Cir. 2009).

10. Bryant P. Lee, Note, *Chapter 18? Imagining Future Uses of 11 U.S.C. § 363 to Accomplish Chapter 7 Liquidation Goals in Chapter 11 Reorganizations*, 2009 Colum. Bus. L. Rev. 520, 530.

This trend toward use of § 363(b) is likely to grow as poor economic conditions continue to increase creditor control over reorganization and because of the lack of available financing to debtors, both of which tend to fuel § 363(b) sales.<sup>11</sup> Thus, the “side door” of § 363(b) may soon “replace the main route of Chapter 11 reorganizations.”<sup>12</sup>

Considering current declining economic conditions, the massive amounts of wealth at stake, and the modern prevalence of § 363 sales in large-scale corporate bankruptcy proceedings, it is prudent to ensure that § 363(b) provides a competent and just medium to protect the diverse interests of all relevant parties and society as a whole. While § 363 sales, on paper, appear to be the ideal way to maximize value for secured creditors, preserve the going concerns of businesses, and keep workers on the job,<sup>13</sup> there is a well-founded fear that quick asset sales run the risk of circumventing the Chapter 11 process.<sup>14</sup> *In re Chrysler LLC* highlights the concerns of courts and academics that § 363 fails to adequately protect the interests of companies’ smaller debt and equity holders<sup>15</sup> and ignores some of the fundamental bankruptcy principles and protections.

Part II of this Note provides the basic framework of the Chrysler bankruptcy agreement for the purposes of analyzing § 363 and the business justification standard. Part III details the development of § 363(b) and three of the primary dangers that exist with § 363(b) asset sales under business justification analysis. Part III then uses the *In re Chrysler LLC* case to highlight the issues in practice. The first issue is § 363(b) sales’ vulnerability to construction as “*sub rosa*” sales, which serve the same purpose of reorganizations but avoid Chapter 11 protection requirements.<sup>16</sup> The second issue is § 363(b) sales’ potential to allow powerful creditors too much influence and control, thereby subordinating and possibly defeating the protected interests of smaller creditors.<sup>17</sup> The third issue is § 363 sales’ exceedingly low return values for the assets sold off in spite of their intended purpose of maximizing decreasing values.<sup>18</sup> Part IV addresses the current standard for approving § 363(b) sales, the business

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11. *Id.* at 531.

12. Jason Brege, Note, *An Efficiency Model of Section 363(b) Sales*, 92 VA. L. REV. 1639, 1640 (2006).

13. Josef S. Athanas, *Section 363 Bankruptcy Sales Attacked by Judges and Commentators Just as Economic Conditions Make Them More Important than Ever*, in BANKRUPTCY AND RESTRUCTURING CHAPTER 11 STRATEGIES 2009, at 39, 56 (2009).

14. *See* Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1069–71 (2d Cir. 1983); *see also* Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 1, 3 (2007).

15. *E.g.*, *In re Lionel Corp.*, 722 F.2d at 1069–71; *see* Brege, *supra* note 12, at 1643–44.

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

17. *E.g.*, *In re Lionel Corp.*, 722 F.2d at 1069–70; *see also* Lee, *supra* note 10, at 524.

18. *See In re Chrysler LLC*, 576 F.3d at 123 (returning an estimated value of \$2 billion for assets with a going concern value of approximately \$25 billion); *see also* Lee, *supra* note 10, at 524.

justification rule,<sup>19</sup> and how the rule wrongly facilitates the approval of dubious asset sales. Part V discusses academic theories for reform of the current business judgment standard as well as its implementation in other areas of the law. Lastly, Part VI synthesizes the differing approaches to the business justification standard and offers a refined framework for assessing § 363 asset sales.

## II. HIGHLIGHTING THE PROBLEM: *IN RE CHRYSLER*

On November 29, 2007, a \$10 billion term loan maturing on August 2, 2013, was made available to Chrysler as a First Lien Credit Agreement.<sup>20</sup> “Chrysler’s obligations . . . [were] secured by a security interest in and first lien on substantially all of Chrysler’s [then-\$39.3 billion in] assets.”<sup>21</sup> On the date of filing, Chrysler owed the first-lien lenders approximately \$6.9 billion under the loan.<sup>22</sup> Later, “under a Second Lien Credit Agreement . . . Chrysler received a \$2 billion term loan [maturing] on February 3, 2014[,]” from affiliates of Daimler and Cerberus.<sup>23</sup> The loan agreement provided that the second-lien lenders had a second-priority security interest in the same assets that secured the First Lien Credit Agreement.<sup>24</sup>

The Emergency Economic Stabilization Act of 2008 established the Troubled Asset Relief Program (TARP), which allows the Secretary of the Treasury to buy troubled assets in order to restore economic confidence and to stimulate the economy.<sup>25</sup> Chrysler borrowed \$4 billion from the U.S. Treasury under TARP, securing the financing by granting the Treasury a first-priority lien on all unencumbered assets and a third-priority lien on all other assets as collateral under the first and second lien agreements.<sup>26</sup> Chrysler “also provided the U.S. Treasury with a separate promissory note in the amount of \$267 million,” which, along with the \$4 billion TARP loan, matured no later than January 2, 2012.<sup>27</sup> However, in order to secure the loan and the note, Chrysler was required to submit a plan to the government, its major creditor, showing a viable long-term solution.<sup>28</sup> Chrysler entered into a term sheet for strategic alliance with Fiat, with whom it had been negotiating for some time prior to the issuance of the loan.<sup>29</sup> This Fiat Viability plan was accepted by the U.S. Treasury,

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19. *In re Lionel Corp.*, 722 F.2d at 1066, 1070; see also James Patrick Shea et al., *Pushing the Limits of Section 363—Is Confirmation Obsolete in the Asset Sale Case?*, 14 J. BANKR. L. & PRAC. 2 art. 2, at 7–8 (2005) (stating that the business justification standard is still the prevalent bankruptcy standard).

20. *In re Chrysler LLC*, 405 B.R. 84, 89 (Bankr. S.D.N.Y. 2009).

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. 12 U.S.C.A. § 5211 (West 2011).

26. *In re Chrysler LLC*, 405 B.R. at 89–90.

27. *Id.* at 89.

28. *Id.* at 90.

29. *Id.*

but only after Chrysler addressed certain governmental concerns.<sup>30</sup>

To satisfy Fiat and the governmental TARP loan concerns, New CarCo Acquisition LLC (New Chrysler) was formed, and the parties created a new collective bargaining agreement with United Automobile Workers (UAW) to establish new wage structures and retirement settlement agreements.<sup>31</sup> This included a voluntary employees' beneficiary association (VEBA) to fund health care obligations<sup>32</sup>. The agreement was funded by a 55% equity interest in New Chrysler as well as a \$4.59 billion note.<sup>33</sup>

Ultimately, the final bankruptcy transaction agreement established that Chrysler would transfer (by § 363(b) sale) all of its operating assets to New Chrysler in exchange for \$2 billion in cash and certain "Old" Chrysler liabilities.<sup>34</sup> Fiat would contribute technology, distribution, and cost saving capabilities to New Chrysler, and New Chrysler would issue relevant interest in the company as follows: 55% to the VEBA, 20% to Fiat, and 8% to the U.S. Treasury.<sup>35</sup> Additionally, the Treasury agreed to provide financing relating to the sale transaction in the amount of \$4.96 billion for 60 days and \$6 billion to support New Chrysler after the sale was completed.<sup>36</sup>

The plaintiff in *Chrysler*, the "Indiana Funds,"<sup>37</sup> filed an objection to the sale motion.<sup>38</sup> "Indiana Funds [held] approximately \$42 million of the \$6.9 billion in first priority secured claims . . ."<sup>39</sup> The Indiana Funds argued that, under the § 363 agreement, the first-lien lenders' collateral would be stripped, and the first-lien lenders would receive twenty-nine cents on the dollar for their investment.<sup>40</sup> The collateral would then be transferred to New Chrysler under the agreement. The plaintiffs believed that the transferred collateral, in the hands of New Chrysler, was worth significantly more than what the plaintiffs received as first-lien lenders.<sup>41</sup> Additionally, the Indiana Fund's and all other senior claims would be impaired in favor of the unsecured junior claims of the Government, VEBA, and UAW, all of which receive considerable value under the agreement.<sup>42</sup> Lastly, the funds believed that Fiat should not receive a stake in New Chrysler without providing cash contributions in addition to the

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30. *Id.* at 91.

31. *Id.* at 91–92.

32. *Id.* at 92.

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.* at 93. Collectively, Indiana State Teachers Retirement Fund, Indiana State Police Pension Trust, and Indiana Major Moves Construction comprise the "Indiana Funds." *Id.*

38. *Id.*

39. *Id.* (representing "less than 1% of the first-lien debt").

40. *Id.*

41. *Id.*

42. *Id.*

technological and distributional support provided.<sup>43</sup> Put simply, as a small and relatively insignificant creditor, Indiana Funds believed its supposedly secured first-lien interest was wrongly losing out to the power and influence of junior, unsecured loan creditors under the court-sanctioned § 363 restructuring. Right or wrong, the circumstances exposed the shortcomings and manipulability of § 363 asset sales.

### III. SECTION 363 AND ITS DANGERS IN PRACTICE

Section 363 asset sales have changed from what was originally intended by the code's drafters and the bankruptcy courts.<sup>44</sup> Section 363(b) originated in the Bankruptcy Act of 1867 and permitted a sale of a debtor's assets when the estate or any part of the estate was "of a perishable nature, or liable to deteriorate in value."<sup>45</sup> Originally, § 363 transactions concerned only expedited sales that were imperative to preserve values that would rapidly diminish.<sup>46</sup> Until the implementation of the Bankruptcy Reform Act of 1978, approval of asset sales required sufficient showing of cause for circumventing standard Chapter 11 reorganization plans.<sup>47</sup> However, recently there has been a movement away from the emergency and cause restrictions toward adopting more liberal standards for approving § 363 sales.<sup>48</sup> The traditional aversion to unrestricted use of § 363 sales,<sup>49</sup> and the major decisions that restricted debtor's use of § 363 asset sales,<sup>50</sup> have given way to the business judgment standard's very broad application by the courts.<sup>51</sup> As evidenced in the *Chrysler* outcome, this broad standard is a tool with which the courts can permit *sub rosa* sales, creditor manipulation, and minimal realized asset values in § 363 sales, all of which fall well short of standard bankruptcy protections.<sup>52</sup>

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43. *Id.*

44. Robert G. Sable, Michael J. Roesenthaler & Daniel F. Blanks, *When the 363 Sale Is the Best Route*, 15 J. BANKR. L. & PRAC. 2 art. 2, at 1 (2006).

45. Act of Mar. 2, 1867, ch. 176, § 25, 14 Stat 517, 528 (repealed 1878); *see also* Ind. State Police Pension Trust v. Chrysler LLC (*In re Chrysler LLC*), 576 F.3d 108, 113 (2d Cir. 2009).

46. *In re Chrysler LLC*, 576 F.3d at 113.

47. *See* Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1067, 1069 (2d Cir. 1983).

48. *See* Craig A. Sloane, *The Sub Rosa Plan of Reorganization: Side-Stepping Creditor Protections in Chapter 11*, 16 BANKR. DEV. J. 37, 51 (1999) (permitting § 363 sales unless there is an obvious reason not to).

49. *In re Chrysler LLC*, 576 F.3d at 113; *see also In re Lionel Corp.*, 722 F.2d at 1067.

50. Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re Braniff Airways, Inc.*), 700 F.2d 935, 940 (5th Cir. 1983) (establishing that *sub rosa* plans will not be upheld); *In re Solar Mfg. Corp.*, 176 F.2d 493, 494 (3d Cir. 1949) (stating that the sale of a debtor's assets outside of reorganization should be confined to emergencies where the assets will lose all value without immediate action).

51. *In re Lionel Corp.*, 722 F.2d at 1066, 1070 (establishing the business justification standard); 7 COLLIER ON BANKRUPTCY ¶ 1129.01[2] (Alan N. Resnick & Henry J. Sommer eds., 15th rev. ed. 2009) (stating that amongst the courts there are different thresholds for permitting the sale of assets outside a bankruptcy plan).

52. *See* LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS

### A. Sub Rosa Sales

The concept of *sub rosa* (“below the line”) plans first appeared in the case of *In re Braniff Airways, Inc.*<sup>53</sup> In discussing the validity of an approved § 363 asset sale, the court said, “[t]he debtor and the bankruptcy court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets.”<sup>54</sup> Essentially, a § 363 plan is *sub rosa* if, similar to basic Chapter 11 procedures, the remaining plan for reorganization is predetermined according to the sale.<sup>55</sup> The *Braniff* court held that in future attempts to establish appropriate terms for § 363 plans, parties and district courts “must scale the hurdles erected in Chapter 11.”<sup>56</sup>

It has been subsequently established that the rights of senior secured creditors cannot be abrogated in § 363 plans and that bankruptcy courts lack the authority to approve such transactions under § 363.<sup>57</sup> However, while the *Braniff* holding provided the language that courts have subsequently used as guidance in *sub rosa* determinations, the court did not explain the appropriate use or procedure of *sub rosa* objections, nor did it specify any direct limitation on the use of § 363 sales.<sup>58</sup> Despite the very explicit determination by the courts that asset selling plans under § 363 must not simply be for the purpose of evading the standards of Chapter 11,<sup>59</sup> through the lack of clarity in the business justification standard, these are precisely the type of asset sales courts have subsequently approved.<sup>60</sup> *In re Chrysler* highlights this potential abuse.

### B. Sub Rosa Approval in *In re Chrysler*

Beyond the actual form of the sale, the *Chrysler* “sale” implements everything that Chapter 11 plans are designed to accomplish without enforcing of any of Chapter 11’s mandated protections.<sup>61</sup> The § 363 sale

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CORRUPTING THE BANKRUPTCY COURTS 9 (2005) (supporting the argument that courts’ liberal § 363 standards have permitted unfathomably corrupt acts by large companies).

53. 700 F.2d at 940.

54. *Id.*

55. See Sloane, *supra* note 48, at 45.

56. Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re Braniff Airways, Inc.*), 700 F.2d 935, 940 (5th Cir. 1983); see e.g., 11 U.S.C. § 1125 (2006) (disclosure requirements); *id.* § 1126 (voting); *id.* § 1129(a)(7) (best interest of creditors test); *id.* § 1129(b)(2)(B) (absolute priority rule).

57. Contrarian Funds, LLC v. Westpoint Stevens, Inc. (*In re WestPoint Stevens, Inc.*), 333 B.R. 30, 49–50 (S.D.N.Y. 2005).

58. *In re Braniff Airways, Inc.*, 700 F.2d at 940.

59. *Id.*; *In re Westpoint Stevens, Inc.*, 333 B.R. at 52.

60. See, e.g., Ind. State Police Pension Trust v. Chrysler LLC (*In re Chrysler LLC*), 576 F.3d 108, 119 (2d Cir. 2009); *In re General Motors Corp.*, 407 B.R. 463, 491, 495–96 (Bankr. S.D.N.Y. 2009).

61. Brief for Appellants Indiana State Police Pension Trust et al. at 43, Ind. State Police Pension Trust v. Chrysler LLC (*In re Chrysler LLC*), 576 F.3d 108 (2d Cir. 2009) (No. 09-2311-bk).

reorganizes the finances and obligations of the debtors and determines the handling of nearly all the creditors without disclosure requirements,<sup>62</sup> voting,<sup>63</sup> the best interest of the creditors,<sup>64</sup> or the priority rule<sup>65</sup> being taken into account.<sup>66</sup> Additionally, calling the transaction a sale is, in itself, construing the word *sale* in the most literal and narrow way possible. The proposed § 363 transaction is a sale only in name as the “New Chrysler” established by the deal will operate exactly as the old Chrysler in every substantive way.<sup>67</sup> The brand name “Chrysler,”<sup>68</sup> headquarters,<sup>69</sup> employees, a majority of management,<sup>70</sup> and lines of cars and trucks<sup>71</sup> are essentially the same under New Chrysler. Thus, Chrysler evaded the procedural and substantive protections of Chapter 11 in reorganizing pursuant to the § 363 sale, and in doing so, it achieved a result that could not be reached through the standard Chapter 11 process.<sup>72</sup> It is unlikely that, in a proper Chapter 11 reorganization plan, first-lien lenders would ever agree to accept value equal to roughly one third of their debt, unless absolutely no alternatives were available.<sup>73</sup> However, Chrysler was able to sidestep this need for creditor approval by disguising the reorganization as a § 363(b) asset sale.<sup>74</sup> Chrysler then based the remainder of the deal on this § 363(b) asset sale and hoped the court would not find it an unacceptable *sub rosa* plan. Using the ambiguity of the § 363 business justification standard, the court obliged.<sup>75</sup>

### C. Influence of Creditors

Another concern is that the Bankruptcy Court’s understanding of adequate minor creditor protections potentially allows a powerful creditor to “run roughshod” over the rights of lesser creditors.<sup>76</sup> In addressing § 363(b) asset sales, the *In re Lionel* court acknowledged the potential for

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62. 11 U.S.C. § 1125 (2006).

63. *Id.* § 1126.

64. *Id.* § 1129(a)(7).

65. *Id.* § 1129(b)(2)(B).

66. *See* Ind. State Police Pension Trust v. Chrysler LLC (*In re Chrysler LLC*), 576 F.3d 108, 114 (2d Cir. 2009).

67. Brief for Appellants Indiana State Police Pension Trust et al., *supra* note 61, at 44.

68. *Id.* (citing Chrysler Master Transaction Agreement § 5.19(b)).

69. *Id.* (citing Chrysler Master Transaction Agreement § 11.01).

70. *Id.* (citing Chrysler Master Transaction Agreement § 6.01).

71. *Id.* (citing Chrysler Master Transaction Agreement, Recitals ¶ 2).

72. *See supra* notes 62–71 and accompanying text.

73. In bankruptcy first-lien lenders are the first to be satisfied. 11 U.S.C. § 1129(b)(2)(B) (2006). Thus, first lien lenders would seek at least a value equivalent to the value of their interest unless it was clear there was no alternative.

74. *Id.* §§ 363(b), 1126.

75. *See* Ind. State Police Pension Trust v. Chrysler LLC (*In re Chrysler LLC*), 576 F.3d 108, 118–19 (2d Cir. 2009).

76. *Contrarian Funds, LLC v. Westpoint Stevens, Inc.* (*In re WestPoint Stevens, Inc.*), 333 B.R. 30, 49–50 (S.D.N.Y. 2005).

creditor influence in the proceedings.<sup>77</sup> “[T]he natural tendency of a debtor in distress [is] to pacify large creditors with whom the debtor would expect to do business, at the expense of small and scattered public investors.”<sup>78</sup> In placating these major creditors, debtors often enter into debtor-in-possession financial arrangements involving restrictive covenants that effectively give control to the creditor.<sup>79</sup> This relationship becomes particularly important when there are insufficient assets to protect creditors’ claims, and thus, creditors have more incentive to participate in reorganizations and sales.<sup>80</sup> Additionally, lesser creditors such as junior secured creditors, unsecured creditors, trade creditors, and equity holders have little ability to oppose decisions once pushed through by more influential major creditors.<sup>81</sup> Thus, the great danger is that highly invested creditors will use their influence to dictate favorable terms or prices for a § 363(b) asset sale at the expense of junior or unsecured creditors who lack the ability to protect their own interests.<sup>82</sup> It appears that the courts are aware of influential creditor dangers.<sup>83</sup> However, courts have approved plans undeniably dominated by the major creditors behind them.<sup>84</sup> Thus, it becomes clear that the inconsistent scrutiny of § 363 sales has allowed debtors to manipulate standard bankruptcy protections.<sup>85</sup> Put simply, there is not an adequate standard to shield the system from unfair dealing and abuse.<sup>86</sup>

#### D. Creditor Manipulation in *In re Chrysler*

*In re Chrysler* demonstrates that, alarmingly, courts can allow primary first-lien lenders to have their interests usurped by the influence of major creditors exerting influence in § 363(b) asset sales.<sup>87</sup> In *Chrysler*, the U.S. Treasury Department (Treasury) represented “(i) the Debtors’ prepetition

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77. Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1069 (2d Cir. 1983).

78. *Id.* at 1070 (quoting S. REP. NO. 95-989, at 10 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, at 5796).

79. Lee, *supra* note 10, at 541–42.

80. Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, at 6 (Columbia Univ. Ctr. for Law & Econ. Research Paper No. 321, 2009), available at <http://ssrn.com/abstract=1081661>.

81. See LoPucki & Doherty, *supra* note 14, at 38–39.

82. See Contrarian Funds, LLC v. Westpoint Stevens, Inc. (*In re WestPoint Stevens, Inc.*), 333 B.R. 30, 49–50 (S.D.N.Y. 2005).

83. See *id.* at 49–50; cf. Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1070 (2d Cir. 1983).

84. See Ind. State Police Pension Trust v. Chrysler LLC (*In re Chrysler LLC*), 576 F.3d 108, 111–12 (2d Cir. 2009) (upholding a government-driven sale of Chrysler over the objections of first-lien lenders); see also *In re General Motors*, 407 B.R. 463, 473–74 (Bankr. S.D.N.Y. 2009) (upholding government-driven sale over objections of lesser lien holders).

85. See *supra* notes 82–84.

86. Elizabeth B. Rose, *Chocolate, Flowers, and § 363(B): The Opportunity for Sweetheart Deals Without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 275 (2006).

87. See *In re Chrysler LLC*, 576 F.3d at 111–12.

third-lien lender, (ii) the Debtor's [debtor in possession] lender, (iii) the exit finance lender, (iv) an equity holder in the purchaser, (v) a TARP lender to the Administrative Agent, . . . and (vi) a TARP lender to both Chrysler FinCo and GMAC."<sup>88</sup> Thus, it is hardly surprising to find that Chrysler did not even participate in negotiations with its two most significant creditor groups.<sup>89</sup> The debtor's own chief financial officer testified that the Treasury essentially took over all major business decisions and responsibilities.<sup>90</sup> The Treasury even decided the time and venue for filing of Chapter 11.<sup>91</sup> The level of involvement by the major creditor in this instance went well beyond influence; it was essentially direct control by the Treasury to get its preferred outcome at the expense of other lenders—in this case, the first-lien secured lenders. Unlikely as such an outcome would seem under standard bankruptcy protections, the §363 plan was approved through the business judgment loophole.<sup>92</sup>

#### E. Undervaluation of Assets

While some approve of the use of § 363 and the asset market's ability to "set efficient prices and ensure fair recoveries for all involved creditors,"<sup>93</sup> in depressed economic climates, "[a]s liquidity vanishes, so too does the ability of potential purchasers to take advantage of any buying opportunity. Less competition for the same assets generally creates an expectation of a lower sale price . . . ."<sup>94</sup> Adequate information is often only offered to small groups of interested parties, making informed participation by outside parties extremely difficult and further reducing competition and expected returns.<sup>95</sup> Thus, rushed sales in depressed markets may not generate bidders or value for encumbered assets, and as a result, companies may be unable to fully satisfy existing creditors or to move forward efficiently through reorganization.<sup>96</sup> In 2007, a study compared the effects of § 363 sales and traditional Chapter 11 reorganizations. Sixty companies were analyzed—half participated in § 363 sales and half in Chapter 11 reorganizations. Not surprisingly, the

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88. Brief for Appellants Indiana State Police Pension Trust et al., *supra* note 61, at 73. In late 2008, the Emergency Economic Stabilization Act of 2008 established the Troubled Asset Relief Program (TARP), which allows the Secretary of the Treasury to buy troubled assets to restore economic confidence and stimulate the economy. 12 U.S.C. §§ 5201, 5211 (2006).

89. Brief for Appellants Indiana State Police Pension Trust et al., *supra* note 61, at 72.

90. *Id.* at 72–73.

91. Office of the Press Sec'y, White House, *Press Background Briefing on Auto Industry by Senior Administration Officials* (Apr. 30, 2009), <http://www.whitehouse.gov/the-press-office/background-briefing-auto-industry-4302009>.

92. *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 576 F.3d 108, 114, 118–19 (2d Cir. 2009).

93. Lee, *supra* note 10, at 536 (citing Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV 751, 756 (2002)).

94. *Id.* at 537.

95. H.R. REP. NO. 95-595, at 225–26 (1977) (explaining the purpose for requiring adequate information with disclosure statements).

96. *See* Lee, *supra* note 10, at 535–37 (discussing undervaluation dangers in § 363 sales).

study concluded that, though the costs were roughly the same, the § 363 sales were significantly worse for creditors.<sup>97</sup> The reorganizations had a restart value averaging 80% of the book value of prior assets versus only 35% of book value for the sale price of assets in § 363 sales.<sup>98</sup> Section 363(b) sales enable businesses to quickly take advantage of immediate and fleeting opportunities to increase or maintain the value of assets.<sup>99</sup> However, statistics clearly suggest that the companies and their creditors are in fact getting just the opposite.<sup>100</sup> One of the primary motivations behind a § 363(b) sale, the expedited sale of assets to preserve value, is in fact what hinders the ability to maximize that value in depressed economies.<sup>101</sup>

#### F. *Diminished Values in In re Chrysler*

In the *Chrysler* proceedings, the bankruptcy court established procedures for submitting bids for assets in less than two weeks.<sup>102</sup> “Debtors also admitted that the bidding procedures were not likely to produce bids for such a large complicated transaction in such a short period of time.”<sup>103</sup> Subsequently, though Chrysler’s assets had a going concern value of roughly \$25 billion, the § 363 sale distribution to the first-lien lenders was calculated on the basis of a \$2 billion dollar liquidation analysis.<sup>104</sup> Although this is a staggering discrepancy in valuation, statistics show that such undervaluations are the norm, rather than the exception, in § 363 sales.<sup>105</sup> Regardless, courts continue to allow § 363 proceedings, which deprive assets, companies, and creditors of their value.<sup>106</sup> These staggering outcomes are made possible on account of bankruptcy courts’ firmly established, easily manipulable § 363 business judgment standard.<sup>107</sup>

In examining these issues, bankruptcy courts clearly recognize the potential dangers of § 363 asset sales to the integrity of the system.<sup>108</sup>

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97. LoPucki & Doherty, *supra* note 14, at 3–4.

98. *Id.*

99. *See* Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1069 (2d Cir. 1983).

100. LoPucki & Doherty, *supra* note 14, at 3–4.

101. *Id.*

102. Brief for Appellants Indiana State Police Pension Trust et al., *supra* note 61, at 14.

103. *Id.* at 14–15.

104. *Id.* at 10, 12; *In re Chrysler LLC*, 405 B.R. 84, 89, 92 (Bankr. S.D.N.Y. 2009).

105. LoPucki & Doherty, *supra* note 14, at 3–4.

106. *See, e.g., In re Torch Offshore, Inc.*, 327 B.R. 254, 261 (E.D. La. 2005).

107. *See* Rose, *supra* note 86, at 275–77 (discussing the manipulation of the business justification standard).

108. *See, e.g.,* Comm. of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1069 (2d Cir. 1983) (establishing the business justification standard); Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re Braniff Airways, Inc.*), 700 F.2d 935, 940 (5th Cir. 1983) (recognizing that an overbroad application of § 363(b) would circumvent the intent of Chapter 11); Contrarian Funds, LLC v. Westpoint Stevens, Inc. (*In re WestPoint Stevens, Inc.*), 333 B.R. 30, 51–52 (S.D.N.Y. 2005) (recognizing limits on § 363(b) authority to alter creditors’ lien rights and

Despite all of this evidence, the Second Circuit in *Chrysler* held that the approval of the § 363(b) sale by the bankruptcy court was not improper.<sup>109</sup> The Supreme Court subsequently vacated its temporary stay of the sale.<sup>110</sup> However, in doing so, the Supreme Court declined to rule on the merits of the case, and the major issues that arise under § 363 sales have yet to be conclusively resolved.<sup>111</sup> The *Chrysler* case unmistakably represents the manifestation of major dangers in § 363(b) plans and, more importantly, the ability under the business justification standard to approve questionable asset sales under § 363(b). The issues raised by *Chrysler* represent an opportunity for the courts to address a major flaw in § 363(b) application, the business justification standard. The current application is simply too manipulable and discretionary to provide adequate protection against the vulnerabilities of § 363 abuse.

#### IV. THE PERMISSIVE STANDARD: BUSINESS JUSTIFICATIONS AND § 363 SALE APPROVALS

Bankruptcy courts have long recognized the need to refine the requirements for § 363 asset sales.<sup>112</sup> But it was not until *In re Lionel*, that a definitive, non-emergency standard for approval was introduced.<sup>113</sup> This standard, the business justification test remains the leading standard for evaluating § 363 asset sales.<sup>114</sup>

##### A. *The Original Business Justification Standard*

The Second Circuit in *In re Lionel* correctly pointed out that, read literally, § 363(b) seems to permit the sale of any property of the estate of a corporate debtor without any regard for the safeguards of the Bankruptcy Code.<sup>115</sup> Yet, while the court did note that such a reading would be a violation of the congressional scheme for reorganizations<sup>116</sup> and declined to extend “*carte blanche*” to the bankruptcy judges in their assessments,<sup>117</sup> it created a malleable standard for assessing § 363(b) sales.

“To balance the competing concerns of efficiency against the safeguards of the Chapter 11 process,” *In re Lionel* required “a good

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finding limits to prevent circumvention of Chapter 11).

109. *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 576 F.3d 108, 118–19 (2d Cir. 2009).

110. *Ind. State Police Pension Trust v. Chrysler LLC*, 129 S. Ct. 2275, 2276 (2009).

111. *Id.* at 2276–77.

112. *In re White Motor Credit Corp.*, 14 B.R. 584, 588 (Bankr. N.D. Ohio 1981) (noting that courts are split on the permissible scope of sales under § 363(b)). “[T]o endow section 363 with the purpose of or a potential for a total reorganization would nullify, at debtor’s option, the major protections and standards of chapter 11 of the Code.” *Id.* at 590.

113. *In re Lionel Corp.*, 722 F.2d 1063, 1069 (2d Cir. 1983) (rejecting the view that § 363(b) requires an emergency situation).

114. Rose, *supra* note 86, at 268.

115. *In re Lionel Corp.*, 722 F.2d at 1069.

116. *Id.*

117. *Id.*

business reason” for approval of a § 363(b) transaction.<sup>118</sup> In providing guidance on how to determine what constitutes sufficient business justification, the court suggested a series of factors:

[A bankruptcy judge] should consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike. [A bankruptcy judge] might for example, look to such relevant factors as the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value. This list is not intended to be exclusive,<sup>119</sup> but merely to provide guidance to the bankruptcy judge.<sup>119</sup>

While these factors represent an attempt at establishing a process of review for bankruptcy judges, the business justification standard does not seem to include any safeguards against the concerns that prompted its formation in the first place.<sup>120</sup> In *In re Lionel*, the standard was initially used to *deny* a § 363 sale but the standard has subsequently been the rationale behind an increased number of sale approvals.<sup>121</sup> Courts have applied the standard inconsistently, relying on *In re Lionel* and other early business justification cases only for factual comparisons.<sup>122</sup> Thus, the business justification analysis established in *In re Lionel* has proven to be a discretionary and loose attempt at a standard, which does not provide a significant degree of guidance to debtors and creditors as they approach the § 363 sale process.<sup>123</sup>

### B. *The Refined Standard*

Because of the broad and variable application of the business justification standard, the bankruptcy courts have subsequently attempted

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118. *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 576 F.3d 108, 114 (2d Cir. 2009).

119. *In re Lionel Corp.*, 722 F.2d at 1071.

120. 11 U.S.C. §§ 1122–29 (2006) (regulating disclosure, solicitation, acceptance, and confirmation of plans).

121. See Brege, *supra* note 12, at 1654; Daniel M. Glosband, *Pathology of Section 363 Sales: Not as Simple as They Look*, 7 J. PRIV. EQUITY No. 4, at 60 (2004).

122. Sloane, *supra* note 48, at 48, 51–53; see also *Stephens Indus. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986) (overruling the emergency rule in the Sixth Circuit and establishing the business justification standard as the majority approach); *In re Rausch Mfg. Co.*, 59 B.R. 501, 503 (Bankr. D. Minn. 1985).

123. 7 COLLIER ON BANKRUPTCY, *supra* note 51, at ¶ 1129.01[2].

to increase justification scrutiny.<sup>124</sup> In approving sales, judges have started considering new factors, including the requirement of good faith in sale proposals,<sup>125</sup> dispositions that are “fair and expeditious,”<sup>126</sup> and many others. However, as with the original factors set out in the *In re Lionel* standard, the newer factors and their supposed increased scrutiny are interpreted as merely non-determinative considerations in case-specific inquiries.<sup>127</sup> Accordingly, scholars opine that these factors are simply flexible additions to an already flexible standard.<sup>128</sup> In determining the meaning and scope of terms such as “good faith” or “fair,” courts have simply relied on the sound business justification analysis.<sup>129</sup> “All of these refinements have been added to the business justification standard in a haphazard way, such that it is no longer clear which factors determine whether a sale is permissible or how all of these factors relate to the actual efficiency of a given sale.”<sup>130</sup> Thus, in spite of attempts to refine the business justification standard, it essentially remains the same discretionary and broad method for reviewing § 363(b) sales.<sup>131</sup> Applied to the dangers of *sub rosa* sales, creditor influence, the under valuation of assets, and additional aspects of the § 363 sale process not discussed in this Note,<sup>132</sup> it becomes abundantly clear that loose business judgment standards can be manipulated to obtain approval for § 363 sales that fall short of traditional bankruptcy protections.

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124. *E.g.*, *In re SGL Carbon Corp.*, 200 F.3d 154, 169–70 (3d Cir. 1999); *Mission Iowa Wind Co. v. Enron Corp.*, 291 B.R. 39, 43 (S.D.N.Y. 2003).

125. *In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143, 149 (3d Cir. 1986).

126. *In re White Motor Credit Corp.*, 14 B.R. 584, 591 (Bankr. N.D. Ohio 1981).

127. *See, e.g.*, *Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters.)*, 324 F.3d 197, 211 n.22 (3d Cir. 2003) (“[C]ourts have not identified with any consistency which circumstances of the debtor’s filing are indicia of good faith.”).

128. Rachael M. Jackson, Survey, *Responding to Threats of Bankruptcy Abuse in a Post-Enron World: Trusting the Bankruptcy Judge as the Guardian of Debtor Estates*, 2005 COLUM. BUS. L. REV. 451, 493–94 (noting the aversion of bankruptcy courts to limiting judges’ discretion).

129. *See In re Condere Corp.*, 228 B.R. 615, 631, 636 (Bankr. S.D. Miss. 1998).

130. Brege, *supra* note 12, at 1654.

131. *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 576 F.3d 108, 116–17 (2d Cir. 2009).

132. The subject is discussed elsewhere.

[T]he Business Judgment rule ought to be inapplicable to break up-fees in bankruptcy cases. The complications of bankruptcy require the courts to conduct a more thorough detailed analysis for every case. Thus, a new uniform and detailed standard, with higher scrutiny than the judicial deference to the Business Judgment Rule, is needed to give guidance to courts . . . .

Andrew S. Brown, Note, *Breaking Up and Making Out (Rich): Recommendations for Revision of Bankruptcy Code Provisions Governing Break-Up Fees Used by Stalking Horse Bidders in § 363 Bankruptcy Asset Sales*, 62 FLA. L. REV. 1463, 1473 (2010).

### C. Finding Justification for § 363 Manipulations

The inconsistent business justification scrutiny afforded § 363 sales and aggressive use of § 363 by debtors have left the current standard unable to sufficiently shield the bankruptcy system from unfair dealing and abuse.<sup>133</sup> Faced with manipulated and improper § 363 sales, courts permit such sales to prevent eminent worse alternatives such as total collapse of the business.<sup>134</sup> This happens because the business justifications presented by the bankruptcy courts generally center around the savings of time or money.<sup>135</sup> Consequently, parties can manipulate the courts' application of business justification by creating immediate necessity, which often serves as an overriding factor when weighing the potential misuses of § 363 sales.<sup>136</sup> Thus, the business justification standard provides a discretionary loophole through which the courts sanction *sub rosa* reorganization, creditor manipulation, extreme under valuation, and countless other characteristics contrary to bankruptcy principles.

#### 1. Justifying *Sub Rosa* Sales

*In re Braniff* established the impermissibility of sales that use § 363 to achieve reorganization without standard Chapter 11 protections.<sup>137</sup> Subsequently, analysis of whether a plan is *sub rosa* has developed into a simple business judgment analysis.<sup>138</sup> In approaching the *sub rosa* analysis, courts have distorted the *Braniff* standard into a self-serving rationale:

The term “*sub rosa*” is something of a misnomer. It bespeaks a covert or secret activity, whereas secrecy has nothing to do with a § 363 transaction. Transactions blessed by the bankruptcy courts are openly presented, considered, approved, and implemented. *Braniff* seems to have used “*sub rosa*” to describe transactions that treat the requirements of the Bankruptcy Code as something to be evaded or subverted.

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133. Rose, *supra* note 86, at 275.

134. See, e.g., *In re Trans World Airlines, Inc.*, 2001 WL 1820326, at \*4 (Bankr. D. Del. Apr. 2, 2001) (stating in approval of a § 363 sale, “TWA had no other strategic transaction available to it and had no other offer for value to which it could turn.”); *In re Brookfield Clothes, Inc.*, 31 B.R. 978, 986 (Bankr. S.D.N.Y. 1983) (stating as justification for plan approval, “[t]he absence of any means on the part of the debtor to return the business to operation”).

135. 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, 7 (1992).

136. *Id.* at 7, 9–10.

137. Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re Braniff Airways, Inc.*), 700 F.2d 935, 939–40 (5th Cir. 1983).

138. See, e.g., Ind. State Police Pension Trust v. Chrysler LLC (*In re Chrysler LLC*), 576 F.3d 108, 117 (2d Cir. 2009) (“[A] bankruptcy court confronted with [a *sub rosa*] allegation may approve or disapprove a § 363(b) transfer that is a sale of all or substantially all of a debtor’s assets, using the analysis set forth in *Lionel* in order to determine whether there was a good business reason for the sale.”); *In re Iridium Operating LLC*, 478 F.3d 452, 466–67 (2d Cir. 2007).

But even in that sense, the term is unhelpful.<sup>139</sup>

Reworded, this explanation suggests that the court's position is that if a plan is approved, then it is not a *sub rosa* plan because it was openly presented and considered by the court prior to approval. Basically, a court's approval of a § 363 sale effectively precludes the possibility that the plan is an impermissible *sub rosa* sale only because the courts approval indicates that it is not. Furthermore, as approval of such plans will be based on the business justification standard, courts can approve *sub rosa* sales with the justification that there is no superior alternative, and then use the approval as the evidence that the sale is not *sub rosa*.<sup>140</sup> This circular logic is centered on the ability to approve § 363 sales with the business justification standard. It is clearly the key component for manipulating a bankruptcy court into approving *sub rosa* sales. Given the courts' aversion to letting businesses collapse entirely and the broad scope of justifications used to prevent this from happening, it is clear that, through the application of business justification by the courts, § 363 sales are extremely vulnerable to *sub rosa* manipulation and abuse.

## 2. Justifying Creditor Manipulation

Creditor influence in § 363 asset sales is not necessarily an unacceptable characteristic which taints the bankruptcy process.<sup>141</sup> However, creditor influence and control do become an issue when powerful creditors, for their own purposes, dictate sales that do not adequately or appropriately serve the interests of other less influential parties to the transaction.<sup>142</sup> This issue becomes a problem when the business justification standard allows such manipulation to happen.<sup>143</sup> Although the *In re Lionel* court found that the appeasement of major creditors did not amount to a good business justification,<sup>144</sup> the considerable deference given to saving time and money gives creditors the ability to dictate § 363 plans and outcomes.<sup>145</sup> As businesses struggle or approach failure, they have the ability to manufacture an emergency by delaying bankruptcy filings until the last possible moment.<sup>146</sup> Large, highly vested creditors are invariably involved in the bankruptcy and reorganization processes to protect their interests and investments.<sup>147</sup> Thus,

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139. *In re Chrysler LLC*, 576 F.3d at 117.

140. *See id.* at 117–19.

141. Lee, *supra* note 10, at 550.

142. *See id.* at 548–50.

143. *E.g.*, *In re Chrysler LLC*, 576 F.3d at 119 (approving a plan in which first-lien lenders received \$6 billion less than the value of their debt while the major creditor, the U.S. Treasury, received substantial considerations as well).

144. *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1070–72 (2d Cir. 1983).

145. *See, e.g.*, Bodoh, Kennedy & Mulligan, *supra* note 135, at 7.

146. There is no rule requiring businesses to file for bankruptcy; they are free to file or fight to preserve the business at their discretion.

147. DOUGLAS G. BAIRD, *THE ELEMENTS OF BANKRUPTCY* 14 (4th ed. 2006).

large influential creditors can influence the manufacture of debtor emergencies in an attempt to restrict the court's ability to deny § 363 sales.<sup>148</sup> The immediate need to keep a business operating as a going concern provides the courts' business justification for allowing debtors and major creditors to push through their own pet deals. The lack of required notice,<sup>149</sup> the burden for objections,<sup>150</sup> and the courts' reluctance to disallow approved plans,<sup>151</sup> all generally deny remaining dissatisfied creditors the ability to do anything about it.

### 3. Justifying Meager Sale Values

As previously stated, the primary objective of business reorganization in bankruptcy has always been to preserve the value of debtor's assets as a going concern.<sup>152</sup> In regard to preserving value in § 363 sales, courts have held that one of the overriding goals is to maximize rather than restrict bidding.<sup>153</sup> In justifying values obtained in § 363 sales, the courts have afforded much deference to the sales' open market bidding practices.<sup>154</sup> However, this business justification wrongly presupposes the openness and competition on the market.<sup>155</sup> Markets cannot assess deal protection fees, credit bidding, and the disparity in available information.<sup>156</sup> The debtor's power to restrict participants in open auctions makes the market exposure standard insufficient as an objective standard.<sup>157</sup> These factors, coupled with the expedited nature of § 363 sales, hinder true and informed open competition and hamper the market's ability to return full or competitive value for assets. Thus, while the bankruptcy code is intended to provide a way for creditors to receive the greatest possible recovery,<sup>158</sup> through business justification, the courts are approving § 363 sales that return values inherently contrary to this recovery principle.<sup>159</sup> Under the old § 363 standard of strict emergency and perishable goods, these low values may have been unavoidable and justifiable.<sup>160</sup> However, the changed nature of

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148. See, e.g., *In re Chrysler LLC*, 576 F.3d 108, 111–12 (2d Cir. 2009).

149. *Contra In re Naron & Wagner, Chartered*, 88 B.R. 85, 88 (Bankr. D. Md. 1988).

150. See *Institutional Creditors of Cont'l Air Lines v. Cont'l Air Lines, Inc.*, (*In re Cont'l Air Lines*), 780 F.2d 1223, 1227–28 (5th Cir. 1986).

151. *LoPucki & Doherty*, *supra* note 14, at 40. (“[W]e know of no modern case in which a large public company debtor proposed a sale and the court refused to approve it.”).

152. See *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527–28 (1984).

153. E.g., *In re Beck Indus., Inc.*, 605 F.2d 624, 637 (2d Cir. 1979); *In re Ohio Corrugating Co.*, 59 B.R. 11, 13 (Bankr. N.D. Ohio 1985).

154. E.g., *In re Torch Offshore, Inc.*, 327 B.R. 254, 258 (E.D. La. 2005) (expressing satisfaction with the returned value for assets after an auction producing multiple bids in less than one day).

155. See *Rose*, *supra* note 86, at 282–83.

156. *Id.* at 282.

157. *Id.*

158. BARRY E. ADLER, DOUGLAS G. BAIRD & THOMAS H. JACKSON, *CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY* 1–3 (4th ed. 2007) (describing the function of bankruptcy law).

159. See *LoPucki & Doherty*, *supra* note 14, at 3–4.

160. *Brege*, *supra* note 12, at 1650–51.

§ 363 and its application dictates that courts' must reform or reassess entrenched business justification rationale or risk continually approving a valuation processes contrary to fundamental bankruptcy principles.

There is no question that the business justification standard and its case-by-case factorial analysis has enabled the approval of extremely questionable § 363 asset sales.<sup>161</sup> While, in the past, the business judgment standard may have served the courts' purposes and traditional bankruptcy standards, "now that Section 363(b) sales have become ubiquitous, it is worth investigating whether this choice remains optimal . . . ."<sup>162</sup> In upholding the business judgment standard, even the bankruptcy courts have recognized the difficulties it presents.<sup>163</sup> In light of these difficulties and the growing prevalence of § 363(b) sales, the shortcomings of the business judgment standard must be addressed in order to preserve the fundamental principles of bankruptcy protection.

While this Note does not seek to address the level of integrity of the bankruptcy court system, it must also be mentioned that some academics suggest that § 363 sales result in poor recoveries because of corruption and self-dealing within the courts.<sup>164</sup> Although this argument may be a "giant blind leap,"<sup>165</sup> this argument highlights potential holes in the system that, at some point, must be addressed.<sup>166</sup>

#### V. IMPROVING THE CURRENT STANDARD

There are plenty of scholarly approaches to refining the bankruptcy business judgment standard, all of which have yet to be adopted by the courts.<sup>167</sup> However, there are two approaches in particular that, though limited individually, can together form the foundation of a framework for a better business judgment standard. Jason Brege, now a North Carolina attorney, suggests a strict efficiency based rule that removes discretion and ambiguity from the § 363(b) approval process.<sup>168</sup> Commentator Elizabeth Rose, on the other hand, suggests procedural adjustments to allow objecting parties access to more information while still preserving courts' discretion throughout the process.<sup>169</sup> While both approaches may prove functional in some circumstances, each has limitations that prevent it from being the ideal solution. Interestingly, in scholars' and the courts' approach to implementing the business judgment standard, neither has

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161. *See supra* Part III.

162. Brege, *supra* note 12, at 1652.

163. *See, e.g.*, *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 576 F.3d 108, 116–17 (2d Cir. 2009) ("As §363(b) sales proliferate, the competing concerns identified in *Lionel* have become harder to manage.")

164. LoPucki & Doherty, *supra* note 14, at 39–41 (arguing that competition among courts for cases causes judges to blindly approve sales by debtors).

165. Athanas, *supra* note 13, at 48.

166. Lee, *supra* note 10, at 541.

167. *E.g.*, Brege, *supra* note 12, at 1642; Rose, *supra* note 86, at 251.

168. *See* Brege, *supra* note 12, at 1658–59, 1673.

169. *See* Rose, *supra* note 86, at 283–84.

made significant use or mention of the application of the corporate business judgment standard.<sup>170</sup> Taking certain corporate business judgment principles into account, along with both the Brege and Rose approaches to the bankruptcy rule, this Note offers an alternative, compromising approach to the business justification standard.

#### A. *Strict § 363 Sales: The Efficiency-Based Rule*

Brege centers his rule-based analysis on the principle that § 363(b) sales must be approved only when they are efficient.<sup>171</sup> Brege describes efficiency as, “when the total value of the sale is greater than the value that would have been recovered through reorganization plus the transaction cost waste incurred in promulgating the sale.”<sup>172</sup> For Brege, the value of the sale is the present value received for the sold asset, the value through reorganization is the expected present value of the asset under a reorganization pathway, and the transaction cost waste is the costs involved in selling the asset under § 363(b).<sup>173</sup> He also accurately points out that inherent in the costs of transactions is the previously mentioned danger of over-influence by major creditors.<sup>174</sup> Although such costs are the most difficult of the factors to calculate or predict, under Brege’s rule, this cost and creditor issue is theoretically moot if the value received in the § 363 sale is higher than by any other means.<sup>175</sup> Brege also undertakes a step-by-step analysis of his formula and how it either addresses or negates all of the factors for consideration under the current business judgment analysis.<sup>176</sup>

However, while efficiency is ideal and should be the goal of any § 363(b) sale, Brege’s strict analysis fails to account for the mitigating circumstances and fact-specific characteristics of individual bankruptcy filings. Nowhere does the analysis take into account the possibility that, though inefficient under this formula, a § 363(b) sale may be necessary to allow a business to continue operation. If the value received under § 363 sale would not be as high as under reorganization, then the inefficient plan would fail. However, the Brege approach ignores the likely collapse of a company that needed the proceeds from such an inefficient sale to continue operations. Courts adopting this strict standard run the risk of denying businesses the ability to continue operating. Such a standard would wrongly “straightjacket the bankruptcy judge so as to prevent him from doing what is best for the estate.”<sup>177</sup> Given the trend in the size and

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170. In all the research done for this Note, not once in any court case or scholarly work was the corporate business judgment standard referenced in relation to bankruptcy courts’ interpretation and implementation of the same rule.

171. See Brege, *supra* note 12, at 1659.

172. *Id.* (stating efficiency = V sale > E reorganization + W sale) For an in-depth breakdown on how each of these factors is calculated, see *id.* at 1659–73.

173. *Id.*

174. *Id.* at 1669.

175. *Id.* at 1670–71.

176. See Brege, *supra* note 12, at 1673–79.

177. *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1069

relevance of the businesses recently attempting § 363(b) asset sales and the danger of denying such businesses the ability to continue, this strict rule must be limited in its application to have any place in the business justification analysis.<sup>178</sup> The best use of the Brege approach is as a bright-line standard or analysis to be used by courts or debtors to refute frivolous or unfounded objections by creditors to § 363 sales. Thus, any efficient plan under the Brege model would be easily approvable by the courts as the most valuable and desirable outcome under the circumstances. However, inefficient plans should not be disposed of right away as Brege suggests and as public policy prohibits. Inefficient plans may still be necessary and are, therefore, in need of further consideration by the courts.

### B. *Informed § 363 Sales: Procedural Improvements*

In her attempts to refine the business justification rule, Rose offers procedurally based improvements as a solution.<sup>179</sup> Her goal is to create more transparent, supervised, and thus, less vulnerable § 363 sales.<sup>180</sup> Rose argues that this can be accomplished in two ways.<sup>181</sup> The first is that objectors to sales have the option to extend the notice period for cause shown, with a low showing standard on account of objectors' time and informational disadvantage.<sup>182</sup> The second is "a tiered system for debtor disclosure requirements."<sup>183</sup> Under Rose's approach, non-suspect sales need only conform to current notice and hearing requirements, while courts should consider heightened requirements for good faith creditor objections.<sup>184</sup> The requests for additional disclosure would still be at the discretion of the courts, which would assess the reasonableness by performing a cost-benefit analysis between the debtor and objecting party.<sup>185</sup> The courts could then, if they chose, require formal disclosure statements in conformity with standard Chapter 11 adequate information standards.<sup>186</sup>

Although it does greatly increase the potential flow of information between all of the parties, better enables them to make informed and fair decisions, and preserves some of the courts' discretionary authority, Rose's

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(2d Cir. 1983).

178. See *U.S. Bankruptcy Filings 1980–2009*, AM. BANKR. INST., <http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=57826> (last visited Feb. 25, 2011) (showing the total number of businesses filing for bankruptcy increased considerably between 2006 and 2008); see also *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 576 F.3d 108, 116–17 (2d Cir. 2009) (stating that in the last twenty-five years, § 363(b) asset sales have become standard practice in large corporate bankruptcies).

179. See Rose, *supra* note 86, at 283–84.

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.*

approach does not appear to take into account the considerable delays it may create. Lesser-preferred creditors that do not receive the full value of their interest and have limited access to information would likely make ignorant yet good faith objections even if a proposed plan was the best possible outcome. Easily attainable extension of the notice period on these grounds, followed potentially by multiple disclosure hearings and requirements, considerably lengthen the § 363 plan process. Rose, herself, recognized that additional requirements and more rigid standards effectively eliminate the advantages of § 363 sales.<sup>187</sup> Rose's framework for notice and disclosure appears extremely vulnerable to misuse and abuse by dissatisfied creditors hoping to stall out or defeat § 363 processes. In order to increase available information and fairness, as Rose suggests, while still preserving the effectiveness of the § 363 sale, a base line standard or rule must exist to protect the system from imposing excessive and efficiency-defeating requirements.

The Brege approach could provide the needed base line standard with which to protect Rose's procedural safeguards from abuse. Sufficient showing of cause for extended notice and disclosure requirements could be determined by Brege's efficiency analysis. A Brege efficient plan would defeat creditors' objections and would rapidly direct the sale toward approval. On the other hand, an inefficient plan under the Brege standard should serve as caution to the courts in regards to the sale. Inefficiency would thus constitute sufficient cause for an increased notice period or grounds for a determination as to expanded disclosure requirements. Ultimately, however, the determination for expanded disclosure or later on, approval as a whole, would come down to the same business justification analysis. It is at this point that the application of corporate business judgment principles provides a good deal of guidance.

### C. *The Other Standard: The Corporate Business Judgment Rule*

While an in-depth analysis of the corporate business judgment rule is beyond the scope of this Note, a glance at its principles and limitations offers some insight into potential improvements of the equivalent bankruptcy standard. The corporate business judgment rule is, in effect, the presumption by courts that directors making non-self-interested business decisions act in good faith and with due care.<sup>188</sup> The policy reasons for the corporate rule are much the same as those offered for the bankruptcy standard.<sup>189</sup> Essentially, the justification holds that directors rather than the courts are charged with management of the business and because of their experience and access to information are better able to make business decisions.<sup>190</sup> "The business judgment rule, therefore, recognizes that courts are ill-equipped to second guess the validity of complex business decisions

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187. *Id.*

188. *Hanson Trust PLC v. ML SCM Acquisition, Inc.*, 781 F.2d 264, 273 (2d Cir. 1986).

189. See Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW 1437, 1441 (1985).

190. *Id.*

made by directors and officers.”<sup>191</sup> As they were put into effect with the same goals and policy concerns in mind, the relevant and applicable part of the corporate rule, with respect to bankruptcy application analysis, is when it does not apply.

The corporate business judgment rule is not an absolute rule; instead, it contains a series of exceptions under which it does not apply.<sup>192</sup> For the purpose of bankruptcy application, two of the exceptions are of considerable importance. The first is that the rule does not apply if the plaintiff can show self-dealing, where directors are on both sides of a transaction or have a personal financial interest in it.<sup>193</sup> The second is that the business judgment rule does not apply when there is any action by a board to prevent the effectiveness of a shareholder vote.<sup>194</sup>

With respect to self-interested transactions, one court stated, “there is no alternative to a judicial evaluation of the fairness of the terms of the transaction other than the unacceptable one of leaving shareholders unprotected.”<sup>195</sup> However, approval of a transaction by the majority of the remaining, disinterested directors is seen as strong evidence that the business judgment rule should apply.<sup>196</sup>

Applied to the bankruptcy law, a similar rationale may be beneficial. If self-interest is found on the part of those involved in § 363 sales, the sale should be subject to greater Chapter 11 scrutiny. Self-interest would not refer to the debtors themselves, who will always be a financially interested party to both sides of the deal, but to major creditors whose interest extends beyond simply the repayment of their interest through the sale of assets. Interest such as creditor involvement in future reorganization financing, or substantial control in the affairs of the debtor or newly created entity, would be strong evidence of a self-interested transaction in need of greater protections. Additionally, as with the corporate standard, approval of the transaction by the majority of the remaining, disinterested creditors should be seen as strong evidence that only the business judgment rule need apply.

In regard to actions by the board to prevent the effectiveness of voter approval, “[a]ction designed principally to interfere with the effectiveness of a vote inevitably involves a conflict between the board and a shareholder majority. Judicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal.”<sup>197</sup> Applied to bankruptcy, this standard would essentially

191. EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES §2:12 (rev. online ed. Thomson Reuters 2011).

192. See DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 12 (3d ed. 1989) (explaining that, for the business judgment rule to apply, directors must be disinterested, exercise due care, act in good faith, and not abuse discretion or waste corporate assets).

193. *Pogostin v. Rice*, 480 A.2d 619, 624, 627 (Del. 1984).

194. *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 659–60 (Del. Ch. 1988).

195. *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 111 (Del. Ch. 1986).

196. *E.g.*, *Grobow v. Perot*, 539 A.2d 180, 190 (Del. 1988).

197. *Blasius*, 564 A.2d at 660.

prevent the business justification analysis from applying to § 363 sales in which approval by the majority of creditors is seen to be wrongly influenced by self-interested creditors to the transaction. Instead, the judicial review by bankruptcy courts should involve the legal obligation of a debtor to his creditors under Chapter 11 bankruptcy standards.

As suggested, the Brege and Rose approaches do not separately articulate a practical alternative to the business justification analysis. However, when combined and included in conjunction with corporate limitation principles, they create a practical, tenable alternative to the current § 363 standard. This new analytical framework addresses the limitations of both the Brege and Rose approaches while preserving the discretion of the courts and respecting the time sensitive nature of § 363(b) asset sales.

#### VI. REFINING AND COMBINING APPROACHES: A BETTER STANDARD

The first question under a refined new § 363 analysis is, as proposed by Brege, whether the transaction is efficient. If the transaction as proposed is efficient, it is mathematically the best possible outcome under the circumstances.<sup>198</sup> Courts should thus liberally and rapidly proceed to approval in spite of creditor objections and without a need for lengthy further analysis. However, if a transaction is inefficient, it should not automatically fail, as Brege suggests.<sup>199</sup> Such a strict interpretation ignores the possibility that inefficient transactions are still necessary to preserve businesses and jobs as a matter of public policy.

Instead, if the transaction is not efficient under the Brege model, the absence of efficiency should serve as sufficient cause for added notice under the Rose approach.<sup>200</sup> The lack of efficiency of the transaction indicates that the value gained in the § 363 asset sale is actually less than would be gained in standard reorganization plans.<sup>201</sup> Thus, the additional delay caused by increasing the notice period would not defeat the effectiveness of § 363. The lower immediate sale value under § 363 is a strong indicator time is not of the essence. This extended notice need not be of considerable duration, instead only long enough for the courts to continue on to the additional disclosure considerations under the Rose approach.<sup>202</sup>

Unlike in Rose's approach, disclosure analysis should not hinge on a balance of the inconvenience to the debtor and the benefit to the objecting party.<sup>203</sup> Instead, as with corporate principles, the courts' consideration for disclosure should focus on the appearance of self-dealing or manipulation of creditor approval. Such consideration still affords the courts limited, but not absolute, discretion. Courts are free to determine the amount of

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198. See Brege, *supra* note 12, at 1659–73.

199. See *id.* at 1672 (suggesting that if a transaction is inefficient, it should not be pursued).

200. See Rose, *supra* note 86, at 283.

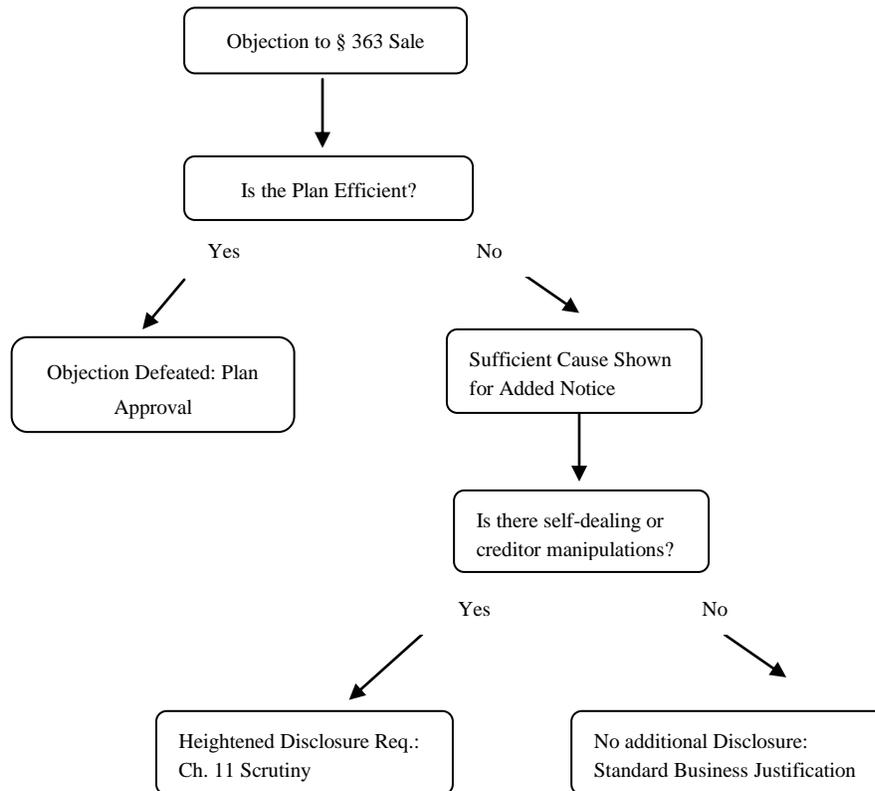
201. Brege, *supra* note 12, at 1659–73.

202. See Rose, *supra* note 86, at 284.

203. *Id.*

involvement and influence they are willing to permit before the integrity of a transaction is compromised. For transactions in which there is an indication of self-dealing or creditor manipulation, courts should require additional disclosure in accordance with Chapter 11 principles. Additional factors that the court deems suspect, such as the subrogation of creditor rights, could be added to those that prompt greater scrutiny. The additional time and scrutiny needed are justified by the potential danger and the apparent existence of impropriety and misuse in the § 363 transaction. If courts find insufficient self-dealing or manipulation, then no additional disclosure or scrutiny requirements are necessary. The standard current business justification factors and analysis should then apply as courts determine whether non-suspect Brege inefficient transactions are justified under the circumstances.<sup>204</sup>

### Refined § 363 Review Procedure



204. See *supra* Part V.C.

## VII. CONCLUSION

The total number of businesses filing for bankruptcy increased by nearly 10,000 from 2006 to 2007, and by more than 15,000 from 2007 to 2008.<sup>205</sup> As previously stated, of the twenty largest public company bankruptcy filings since 1980, seventeen have taken place since 2001, and ten of those seventeen were filed between March of 2007 and August of 2009.<sup>206</sup> These statistics highlight the eminent importance of bankruptcy law, especially with regard to the increasingly pervasive § 363(b) asset sales. Whether in this recession or in the future, as these massive companies fail, they will turn to § 363(b) to survive. Therefore, considering the size and influence of the businesses at stake, ensuring the proper application and analysis of § 363(b) sales is imperative. The business justification standard as an analytical tool is no longer sufficient to prevent the potential misuse of § 363(b) by increasingly knowledgeable and desperate debtors and creditors. Courts must adopt a new standard that protects the principles of bankruptcy against fraudulent uses of § 363 without eliminating its essential advantages or restricting the courts' ability to effectively govern increasingly intricate and unique bankruptcy transactions.

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205. See *U.S. Bankruptcy Filings 1980–2009*, *supra* note 178.

206. See *20 Largest Public Company Bankruptcy Filings 1980—Present*, *supra* note 1.

