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Chrysler and General Motors

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A Reassessment of Bankruptcy Reorganization After Chrysler and General Motors

Barry E. Adler*

Abstract. The descent of Chrysler and General Motors into bankruptcy threatens the Chapter 11 reorganization process itself. In each case, a judge approved a transfer of a debtor's assets to favored creditors under circumstances where holders of other claims were denied basic safeguards. Legal reform is required, and proposed here, to assure that aggrieved creditors are granted protection either of the marketplace or of the Bankruptcy Code's creditor democracy provisions. Such reform could help minimize the cost of capital faced by future debtors.

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

After brief analysis of the Chrysler and GM cases, below, and a short description of potentially negative consequences, I comment on how these cases fit into current bankruptcy practice and how bankruptcy courts might disadvantageously extend these precedents. Finally, I offer a proposal for an amendment to the Bankruptcy Code to curb potential excesses. The proposal is designed to ensure that future bankruptcy courts honor

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* Bernard Petrie Professor of Law and Business, New York University. This article is based on testimony given before the Congressional Oversight Panel's July 27, 2009 hearing on assistance to the automobile industry under the Troubled Asset Relief Program. I thank Douglas Baird, Steve Choi, Tom Jackson, Marcel Kahan, Troy McKenzie, Ed Morrison, Bob Rasmussen, and Mark Roe for conversation that was valuable in the preparation of that testimony and this article.

The earlier, working title of this article, "What's Good for General Motors," came from a famous, or infamous, quote by Charles Erwin Wilson, General Motors president and later Secretary of Defense, who testified in 1953 before the Senate Armed Services Committee that "for years I thought that what was good for the country was good for General Motors and vice versa."

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the entitlement for which creditors contract and without which one cannot expect them to lend on favorable terms.

I. The Chrysler Bankruptcy

The rapid disposition of Chrysler in Chapter 11 was formally structured as a sale under §363 of the Bankruptcy Code.[1] While that provision does, under some conditions, permit the sale of a debtor's assets, free and clear of any interest in them, the sale in Chrysler was irregular and inconsistent with the principles that undergird the Code.

The most notable irregularity of the Chrysler sale was that the assets were *not* sold free and clear, but rather the purchaser, "New Chrysler"—an affiliation of Fiat, the U.S. and Canadian governments, and the United Auto Workers ("UAW")—took the assets subject to specified liabilities and interests. More specifically, New Chrysler assumed about $4.5 billion of Chrysler's obligations to, and distributed 55% of its equity to, the UAW's voluntary beneficiary employee association ("VEBA") in satisfaction, perhaps full satisfaction, of old Chrysler's approximately $10 billion unsecured obligation to the VEBA (which is a retired workers benefit fund).[2] So long as New Chrysler remains solvent, this means that at least half of its obligation to the VEBA will be paid. This, while Chrysler's secured creditors are to receive only $2 billion in satisfaction of about $7 billion in claims, about 30 cents on the dollar. That is, money that might have been available

1 The Bankruptcy Code appears in Title 11 of the United States Code.

2 Although there is a distinction, legal as well as practical, between the UAW and its VEBA fund for retired union workers, for simplicity of exposition, such distinction is generally ignored in this article, which sometimes treats as interchangeable payments to the UAW on account of its claims in bankruptcy and transfers to the VEBA.

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to repay these secured creditors was withheld by the purchaser to satisfy unsecured obligations owed the UAW. Thus, the sale of Chrysler's assets was not *merely* a sale, but also a distribution—one might call it a diversion—of the sale proceeds seemingly inconsistent with contractual priority among the creditors.

To be sure, the situation is more complicated than may first appear. The purchaser in this case was funded primarily by the U.S. government, which had previously advanced $4 billion in funds from the Troubled Asset Relief Program ("TARP") and, along with the Canadian government, agreed to loan the new enterprise billions more. The government had political reasons to assure continuation of auto production and toward that end may have been willing to pay more for the assets than they were worth. For purposes of bankruptcy law, then, the question is not whether the government paid the UAW (or holders of other assumed obligations) too much, but whether the process deprived the secured creditors of a return to which the law entitles them. Some of these creditors, albeit a minority, objected to the sale because they believed they should have received more and would have but for the orchestration of the sale by the U.S. Treasury and automotive task force.

Proponents of the Chrysler sale argue that the sale was proper despite the protests. They contend that the secured creditors who objected to the sale were a minority of such creditors and as a minority lacked standing to complain, a point to which I return below. More fundamentally to the bankruptcy analysis, the proponents of the transaction insist that the company's assets would have been worth little in liquidation and so the secured

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creditors should have been satisfied with the return the bankruptcy sale provided them. But there was no market test of this proposition because Judge Gonzalez, who presided over the Chrysler case, permitted only days for a competitive bid to challenge the proposed sale and restricted bids to those that were willing to have the bidder assume specified liabilities, including Chrysler's obligation to the VEBA.[3] (There was an exception to this restriction for specially approved bids, but noncompliant bids were not entitled to information about the company that qualified bidders could access and, by the court's order, the UAW had to be consulted before a noncompliant bid would be approved.)

Given the constraint on bids, it is conceivable that the liquidation value of Chrysler's assets exceeded the company's going-concern value but that no liquidation bidder came forward because the assumed liabilities—combined with the government's recession-driven determination to have the company stay in business—made a challenge to the favored sale unprofitable, particularly in the short time frame afforded. It is also possible that, but for the restrictions, there might have been a higher bid for the company as a going concern, perhaps in anticipation of striking a better deal with workers.[4] Thus, the approved sale may not have fetched the best price for the Chrysler assets. That is, the diversion of sales proceeds to the assumed liabilities may have been greater than the government's subsidy of the transaction, if any, in which case the secured creditors would have

[3] The bankruptcy court opinion in Chrysler appears at 405 B.R. 84 (Bankr. S.D.N.Y. 2009). This opinion has now been affirmed, 2009 WL 2382766 (2nd Cir.).

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[4] Note that these restrictions would have prevented credit bidding even if the secured bondholders had collectively desired to make such a bid because the required assumption of liabilities effectively eliminated the secured lender priority that is necessary for a credit bid.

suffered a loss of priority for their claims. There is nothing in the Bankruptcy Code that allows a sale for less than fair value simply because the circumstances benefit a favored group of creditors.

Against this criticism, the sale is defended on the ground that quick action was required to preserve the company's going concern value, but it is not certain that this was so or that the company's going concern value exceeded its liquidation value. Moreover, restrictions placed on the bidding process do not appear to be sensible even given a time constraint. The sale served the government's desire to assure continuation of the company and to protect the union's interest, but it is not apparent that the sale was designed to maximize the return to the bankruptcy estate and there seems no legitimate reason to have restricted bids based on the bidders' willingness to assume favored liabilities. To be sure, the United States government possesses significant leverage as perhaps the only available lender to the debtor in bankruptcy—referred to as a "Debtor in Possession" or "DIP" lender. But the fact that a lender, even the only lender, wants an immediate sale does not imply that the debtor should make the requested concession. Indeed, as discussed below, a court's unwillingness to have the debtor buckle under may increase the debtor's bargaining position and thus the return to the estate. Therefore, despite the argument that the debtor was served by a quick, bidder-restricted sale, approval of such a sale over dissent runs afoul of the Supreme Court's admonishment, in the analogous case of *North LaSalle*

Street, that a court should not settle a valuation dispute among parties with a determination "untested by competitive choice."[5]

Viewed another way, the approved transaction was not a sale at all, but a disguised reorganization plan, complete with distribution to preferred creditors. In this light, the secured creditors who objected to the sale and distribution did not necessarily have a complaint with the amount paid (by the government) for the assets. Indeed the objecting creditors may well concede that the amount paid *to the UAW* was quite high; they objected to the distribution, which favored others at their expense. That is, the objection was to the fact that the approved transaction—a de facto reorganization plan—illegitimately distributed assets inconsistently with the priorities established under the Bankruptcy Code.[6]

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5 Bank of America v. 203 North LaSalle Street Partnership, 526 US 434, 458 (1999). In *North LaSalle Street*, the prebankruptcy shareholders of an insolvent debtor in bankruptcy offered to pay for a continuing equity interest in the reorganized entity. When a creditor protested, the shareholders asked the bankruptcy court to affirm the exchange over the objection. The Supreme Court ruled that even if the bankruptcy judge believed the price offered to be a fair, the court lacked the authority to approve the transaction absent a market test of the price. The Bankruptcy Code provisions in the case were not entirely the same as those at issue in the Chrysler, or General Motors, case, but the principle applies equally well.

6 As well summarized by Mark J. Roe and David Skeel, Assessing the Chrysler Bankruptcy (working paper, 2009), many bankruptcy courts have determined that a de facto reorganization plan is improper. See also, Scott D. Cousins, Chapter 11 Asset Sales, 27 Del. J. Corp. L. 835 (2002). For an example of a recent decision, see In re Iridium Operating LLC, 478 F.3d 452 (2d Cir. 2007).

Although the emphasis in this article is on the distribution of value among creditors rather on the propriety of a sale in the first instance, the case law does address the latter. Under the law, the proponents of an all or almost all asset sale must demonstrate a business reason to hold a sale rather than reorganize the debtor in the traditional way, with assets in place. This was true, for example, in the Chrysler case itself, where the bankruptcy court (as well as the court of appeals) was satisfied that there was a valid business reason for the §363 sale. In this article, which critiques the Chrysler and GM bankruptcy cases, I don't question whether the business justification requirement was satisfied in the cases I examine simply because I think that the requirement is ill-advised. In my view, an unconditional auction designed to achieve the highest return for the bankruptcy estate should always be permitted; I would not

Analysis turns next, then, to whether the objecting secured creditors could have blocked the transaction had the distributions in the case been subject to the rules prescribed by Chapter 11 rather than as part of a §363 sale.[7] One who would defend the approved transaction would say "no," relying again on the contention that the liquidation value of Chrysler was so small that the secured creditors received at least their due from the sale, an amount that the judge deemed satisfactory. What this argument overlooks, however, is that Chapter 11 contains rules—sometimes called creditor democracy provisions—designed precisely to protect creditors from a judicial determination with which the creditors disagree. When Judge Gonzalez approved the Chrysler sale, he stripped these protections from the secured creditors.

More specifically, the Chapter 11 rules that shield creditors from judicial error are called "fair and equitable" and "no unfair discrimination" provisions, which appear in §1129(b) of the Code and govern the confirmation of reorganization plans. The requirement that a reorganization plan be fair and equitable means that if a class of claims objects to the distribution under the plan, the plan may not be confirmed if the objecting class is not paid in full while a lower-priority class receives anything under the plan. The requirement that a plan not discriminate unfairly means that if a class of claims objects to the distribution under the plan, the plan may not be confirmed if a class of equal priority receives a higher rateable return under the plan. When applicable, these provisions pre-

interpose the vague obstruction of business justification. My concern with the Chrysler case, and the GM case, described below, is that there was no such auction.

[7] For a similar analysis, which reaches many, though not all, of the same conclusions, see Roe & Skeel, *id*.

vent confirmation *even if* a judge is convinced that the claims in the dissenting class are receiving at least what they would receive in liquidation. Whether the dissenting class believes that the judge is mistaken as to the true liquidation value of the firm or merely demands its share of what it believes to be a firm's going concern surplus over liquidation value, the class can decide for itself whether to accept the plan.

In Chrysler, the dissenting secured creditors attempted to invoke the protection against unfair discrimination. Whatever the judge might deem to be the liquidation value of their collateral, §506 of the Bankruptcy Code bifurcates an undersecured claim—a claim that exceeds the value of its collateral—into a secured portion and an unsecured portion. The secured portion is equal to the judicially determined value of the collateral; the unsecured portion is equal to the deficiency claim. The secured creditor objectors to the Chrysler sale based a legal challenge on the treatment of their deficiency claims. A deficiency claim, like the UAW claims, is a general unsecured obligation and these claims have the same priority. Yet while the sale and distribution approved in Chrysler paid the deficiency claims nothing, it paid the UAW claims with billions of dollars. This, the objectors argued, is an unfair discrimination that would have rendered unconfirmable a formal reorganization plan and should have rendered illegitimate what they saw as a de facto reorganization embodied in the sale and distribution.

There is merit in the dissenters' argument. To be sure, proponents of the pro-UAW distribution can argue that the right to veto a plan on the basis of unfair discrimination is a class-based right—not available to individual dissenters within an accepting class of claims—and that a large majority of the secured creditors accepted the distribution.[8] But the accepting secured creditors were largely recipients of government TARP funds and thus arguably beholden to the government, which engineered the distribution to the UAW. Therefore, under §1122 of the Bankruptcy Code and relevant precedent, in a formal reorganization, the judge might have been obliged to classify the TARP lenders separately from the non-TARP creditors, thereby giving the dissenters control over their own class and, perhaps, the right to veto the UAW distribution as unfairly discriminatory. Against this unfair discrimination contention, plan proponents can argue further that the payment to the VEBA not as a distribution on account of an unsecured claim at all, but rather as prospective expense that assured the company a needed supply of UAW workers, with the union thus portrayed as a critical vendor of labor. However, even if one assumed that the automaker's value was greater as a going concern than in liquidation, one wonders whether so large a transfer to its labor force would have been necessary in this depressed economy. In any case, because the court characterized the transfer of assets from Chrysler to New Chrysler as a sale rather than as reorganization, it didn't need to reach the classification issue or the critical vendor issue. Consequently, this characterization improperly denied the dissenters the chance at the full protections of the Bankruptcy Code.

The foregoing assumes that the dissenting secured creditors had standing to object to the proposed, and ultimately approved, sale of Chrysler's assets. As noted above, propo-

[8] Section 1126 of the Bankruptcy Code provides that a class of claims accepts a plan if a majority of claim holders, holding at least two-thirds of claims by amount, accepts the plan.

nents of the sale argued that the dissenters, as a minority of the secured creditors, lacked such standing. The proponents pointed to a provision of the secured creditors' loan agreement that arguably granted an agent of the creditors the right to sell their collateral on behalf of the group. According to this argument, because the creditors' agent was obliged to represent the secured creditor majority that favored the sale, the agent properly consented to the transaction on behalf of all secured creditors. Judge Gonzalez agreed and approved the sale, despite the lack of a true auction, in part because, in his opinion, given the agent's consent, there was no objection. The judge rejected the dissenters' claim, among others, that the influence of the TARP lenders among the secured creditors tainted the agent's authority.

Whether Judge Gonzalez was correct to rule that the secured creditor dissenters should be deemed to have consented to the sale of their collateral is a matter of state contract law rather than bankruptcy law. But even if the judge correctly interpreted state law, Chrysler remains an unsettling bankruptcy precedent because approval of a sale of assets under §363 is not limited to a case where the affected parties consent. Some courts permit a sale free and clear of liens despite the objection of a secured creditor who will not be fully repaid by the proceeds.[9] Moreover, a §363 sale of a debtor's assets may occur over the objection of an unsecured class of claims, one that disputes the efficacy of a sale because the creditors believe they would, despite their lack of priority, receive a better dis-

[9] Section 363(f) of the Bankruptcy Code, which provides the conditions for a sale of assets free and clear of interests in those assets, is poorly drafted and internally inconsistent. On one reading of the provision, property cannot be sold free of liens unless the sale proceeds are sufficient fully to satisfy those liens. On another reading, there is no such requirement. See In re PW, LLC, 391 B.R. 25 (9th Cir. BAP 2008), which describes the varying judicial interpretive approaches.

tribution if the sale is disallowed. (Indeed, in Chrysler itself, there were unsecured creditors—tort claimants, e.g.—who objected to the sale on other grounds and may have had a valid argument, as a class, on this ground as well.) Thus, given the holding in Chrysler, if a sale of a firm's assets is to occur without a market test, there remains the opportunity for courts to approve a de facto reorganization plan that fails to protect creditor entitlements even over the objection of the disadvantaged creditors.

There are at least two negative consequences from the disregard of creditor rights. First, at the time of the deviation from contractual entitlement, there is an inequitable distribution of assets. Take the Chrysler case itself, where the approved transaction well-treated the retirement funds of the UAW. If such treatment deprived the secured creditors of their due, one might well wonder why the UAW funds should be favored over other retirement funds, those that invested in Chrysler secured debt. Second, and at least as importantly, when the bankruptcy process deprives a creditor of its promised return, the prospect of a debtor's failure looms larger in the eyes of future lenders to future firms. As a result, given the holding in Chrysler, and the essentially identical holding in the General Motors case, discussed next, one might expect future firms to face a higher cost of capital,[10] thus dampening economic development at a time when the country can least well afford impediments to growth.

[10] Although I am unaware of empirical support for the claim that the Chrysler and General Motors cases will increase the cost of capital to corporate debtors, the cases are still new and it is not clear whether they will be extended, a topic to which I return in Part IV, below.

II. General Motors

Chrysler was a blueprint for the General Motors bankruptcy, which, like that of Chrysler, included a sale of the debtor's valuable assets to an entity that assumed unsecured obligations owed its workers or former workers. In the case of GM, the purchaser, "New GM," owned largely by the United States Treasury, agreed to satisfy General Motors' approximately \$20 billion pre-bankruptcy obligation to the VEBA with a new \$2.5 billion note as well as \$6.5 billion of the new entity's preferred stock, 17.5% of its common stock, and a warrant to purchase up to an additional 2.5% of the equity; depending on the success of New GM, the VEBA claim could be paid in full. As in the Chrysler case, the sale procedures required that, absent special exemption, any competing bidder was to assume liabilities to the UAW as a condition of the purchase. Therefore, once again, there was no true market test for the sale.

The primary difference between the cases, other than much larger size of General Motors, is that in GM there were no objections to the sale by holders of senior-secured claims, which were held by the United States or Canadian governments or were to be assumed by the purchaser. Rather, in the case of General Motors, the United States and, to a lesser extent, Canadian governments were both the sponsors of the asset purchase that favored the UAW and the senior lenders from whose pockets any consequent diversion of value likely came. In particular, the United States Treasury, under TARP authority, lent GM about \$50 billion in a combination of pre- and post-petition secured transactions; the governments assigned these obligations to New GM, which then credit bid for the assets. Some unsecured creditors objected to the transaction. But while the unsecured claims are substantial—including about $27 billion in unsecured bonds alone—the GM bankruptcy estate will receive between 10% and 12% of the shares of New GM plus warrants for additional shares. The value of these shares and warrants, plus that of other assets not tendered to New GM, may well exceed any plausible bid—net of the secured claims—that GM could have received from anyone else for the GM assets.

Still, just as in the case of Chrysler, the approval of a restricted bid process establishes a dangerous precedent, one that went unnoticed, or at least unnoted, by the court. In his opinion approving the GM sale, Judge Gerber addresses the objections of some unsecured creditors and makes the following observation:

> A 363 sale may … be objectionable as a [disguised reorganization] plan if the sale itself seeks to allocate or dictate the distribution of sale proceeds among different classes of creditors. But none of those factors is present here. The [sale and purchase agreement] does not dictate the terms of a plan of reorganization, as it does not attempt to dictate or restructure the rights of the creditors of this estate. It merely brings in value. Creditors will thereafter share in that value pursuant to a chapter 11 plan subject to confirmation by the Court.[11]

In this passage, however, Judge Gerber ignores the sales procedure, which, like that in Chrysler, strictly limited the time for competing bids and, subject to the limited exceptions made also in Chrysler, restricted bidders to those willing to assume significant UAW liabilities. The process thus precluded a potentially higher bid by a prospective purchaser who was unwilling to make the same concessions to the UAW that the government-sponsored purchaser was willing to endure. Thus, there remained the theoretical possibility that the process impermissibly transferred asset value from the company's

[11] In re General Motors, Corp. 407 B.R. 463 (Bankr. S.D.N.Y. 2009)

other creditors to the UAW. This is merely a theoretical possibility. As noted above, it may well be that no creditor other than the government secured lenders suffered a loss of priority from the transaction. But the case stands as precedent that might cause later lenders to doubt whether future debtors will be forced to live up to their obligations. And as also noted above, wary lenders are inhospitable to economic development.

III. Past as Prologue

Against these or similar criticisms of the Chrysler and General Motors bankruptcy cases, two defenses have been raised, each in tension with the other. The first defense is that Chrysler and GM broke no new ground. The second is that Chrysler and GM are so unusual as not to matter. I address each of these claims in turn.

As noted above, in each of the two automaker cases, government as sponsor of the sale was also a significant lender to the bankrupt debtor. As Ed Morrison has observed in his contribution to this debate, it is common for such a lender—a DIP lender—to impose its will on the bankruptcy process.[12] Particularly where a debtor has few or no unencumbered assets to offer a prospective DIP lender, a dominant prebankruptcy secured creditor may be the bankrupt debtor's only source of affordable, needed funds and this position can provide such a creditor great influence, enough to dictate the terms of a sale even over the dissent of other creditors. The terms so imposed, moreover, may at times include a quick sale and the requirement that competing bidders assume whatever liabilities the

[12] Edward Morrison, Chrysler, General Motors, and the Future of Chapter 11 (working paper, 2009).

secured lender wants assumed and for whatever reason. Against this background, Chrysler and GM may seem more part of an existing trend than a startling new development.

This may be so. Chrysler and General Motors may be just the most prominent examples of how Chapter 11 can be manipulated to deprive dissenting creditors of (what should be) their entitlement to either a market test or process protections afforded by the Bankruptcy Code's reorganization provisions. But this observation does not make such manipulation more palatable. If a court made clear that it would not approve an undeserved distribution to a DIP lender or its designee—or any other form of overpayment—the lender would have no incentive to withhold needed funds if the debtor offered a merely fair price for the loan. Bankruptcy policy is not served when a DIP lender uses a monopoly position as financier to capture the benefits of the bankruptcy process' value-enhancing provisions such as the automatic stay and the sale of assets free and clear of liens. A DIP lender should be afforded an ordinary return on its postpetition investment, but there is no apparent reason it should receive more. And while judicial approval of a process susceptible to diversion of value may have occurred before, Chrysler and GM *are* prominent examples, cases where the issue of diversion was presented front and center rather than buried in approval of an obscure sale order. The process approved in these cases, or processes like it, may now become more common.

All this said, it is tempting to dismiss the Chrysler and General Motors bankruptcy cases as sui generis. Prompted by the political pressures created by the recession and financial crisis, the government insinuated itself into the process with cash in hand, and it may be that the cash was sufficient to pay everyone at least its due. The dissenters may have been greedy, not victims. And if the judges saw things this way, they may have been willing to approve a process that would not have survived their scrutiny under ordinary circumstances. But even if this is all true, the cases establish a precedent that could undermine the bankruptcy process in the future, even if the government recedes from the scene.

Consider the following illustration, where the government as lender or purchaser is nowhere to be found. Imagine a simple firm, Debtor, with only two creditors, each unsecured: Supplier, owed $60, and Bank, owed $20. After Debtor runs out of working funds and files a bankruptcy petition, Bank offers $40 for all of Debtor's assets (which Bank intends to resell). Bank contends that this is the best offer Debtor is going to get and that if Debtor does not accept the offer immediately Debtor will have no choice but to liquidate piecemeal for $10. The court agrees and approves the sale over Supplier's objection even though there is no auction or other market test for the value of the assets. After the sale, Debtor moves through the ordinary bankruptcy process and distributes the $40 proceeds ratably between Supplier and Bank, with $30 to Supplier and $10 to Bank.

As long as the court is correct to accept Bank's valuation, the sale and the distribution are appropriate. But what if the court is wrong? Assume that Debtor's assets are worth $60. In this case, Supplier should receive $45 and Bank $15. But the sale and distribution approved by the court has different consequences. Instead, Bank pays $40 for assets worth $60 (i.e., gains $20) then receives a $10 distribution from Debtor's bankruptcy estate, for a total effective distribution of $30, half the true value of Debtor's assets, twice the amount to which it is entitled. All this while, as a formal matter, it is correct to say, as the courts did in Chrysler and GM, that the sale proceeds were distributed fairly among the creditors. The problem, of course, is not with the distribution of sale proceeds received; the problem is with the diversion of value to the purchaser, which paid the estate too little and thus, in its role as a creditor, received too much. This is Supplier's complaint in this illustration and the dissenting creditors' complaint in the Chrysler and General Motors cases.

In this illustration, an auction would solve the problem—because a bidder would offer $60 foiling Bank's scheme—as would granting Supplier a veto over the sale to reflect its dominant position in what would be the unsecured creditor (and only) class were the proposed distribution part of a reorganization plan. With neither protection in place, Supplier is left to suffer the consequences of judicial error, which can occur no matter how skilled or well meaning the judge; skilled and well meaning are not synonymous with omniscient.

As Mark Roe and David Skeel observe in their own criticism of the Chrysler bankruptcy, the ability of a court to approve an untested sale at the behest of some creditors over the objection of others without the safeguards prescribed by the Bankruptcy Code returns us to a past centuries' practice referred to as the equity receivership, where it was widely believed that powerful, favored creditors routinely victimized the weak and unconnected.[13] The Chrysler and General Motors cases are a step back and in the wrong direction.

IV. Proposed Reform

The Chrysler and General Motors cases are objectionable because they include a sale of virtually all of the debtors assets under §363 of the Bankruptcy Code without a market test for the value of those assets. In Chrysler and in GM, had the price paid for the assets been undeniably fair, dissenting creditors would have had no basis for complaint so long as they received a ratable share of the sale proceeds consistent with their levels of priority. In neither case, however, was the price undeniably fair. It is problematic that in each case the process favored some creditors over others through the assumption of some claims and the consequent relegation of others to receive perhaps inadequate sales proceeds.

A response to this problem could be a ban on the use of §363 to sell all or substantially all of the assets of a debtor in bankruptcy. Without a sale as a tool for de facto reorganization, a court would be forced to follow the Bankruptcy Code's procedural provisions in an actual reorganization of a debtor and could not easily deprive creditors of the Code's protections. This response would be excessive, however. As long as a sale of a firm's assets is subject to a true market test, a sale may be the best and most efficient way

13 See Roe & Skeel, cited in note 7; see also David A. Skeel, Jr., Debt's Dominion: A History of Bankruptcy Law in America 48-70 (2001) (describing the equity receivership and its faults).

to dispose of an insolvent debtor. Indeed, bankruptcy courts have increasingly, and usefully, conducted all-asset sales.[14] The key is to ensure a *true* market test.

State courts have significant experience in deciding whether a proposed sale of a firm is likely to achieve the best price for investors. Under a line of cases that comprise what is referred to as the *Revlon* doctrine, the Delaware courts have imposed a standard that directors must meet when a corporation is up for sale. While this standard does not require any particular process in every case, the courts have suggested that there is a general obligation for the directors of the firm to hold an auction or conduct some other form of market test if there is a doubt about the true value of the firm.[15] Congress would do well to establish as a minimum procedural safeguard state law requirements for §363 sales of all or substantially all of a debtor's assets, at least where the debtor is large enough to justify the administrative expense of such a process.

In addition, as described above, the requirement that a bidder assume some of a debtor's liabilities dictates the distribution of sale proceeds, and cannot enhance the amount of those proceeds. Therefore, a condition of liability assumption is not a proper part of any sale, and should not be permitted, regardless of applicable state law.

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[14] This trend is noted in the Second Circuit's affirmation of Chrysler, 2009 WL 2382766, which sites, e.g., Douglas G. Baird and Robert K. Rasmussen, The End of Bankruptcy, 55 Stan. L. Rev. 751 (2002).

[15] The recent Delaware Supreme Court case of Lyondell Chemical Co. v. Ryan, 970 A.2d 235 (Del. 2009) summarizes the current state of the *Revlon* doctrine (though the holding of *Lyondell* addresses only a narrow issue of director liability).

To accomplish these ends, Congress could add to the Bankruptcy Code a new subsection of *§363*, one that would provide:

> *The trustee may sell property under subsection (b) or (c) of this section only if—*
>
> *(1)(A) where the debtor is not a small business debtor, the sale of all or substantially all of the debtor's assets complies with the requirements that would be imposed on the debtor by applicable nonbankruptcy law if the debtor were a corporation that was not a debtor and if such corporation's equity interest were publicly traded and subject to a bid for control; and (B) the process for the sale of such property imposes no condition, whether or not subject to exception, that an offeror agree to assume or pay some but not all claims; or*
>
> *(2) no holder of a claim, except a claim that will receive on account of such claim cash equal to the allowed amount of such claim upon distribution of the property of the estate or as of the effective date of the debtor's confirmed plan, objects to the sale.*

This provision, if adopted, would not apply to a small business debtor,[16] which cannot be expected to absorb the expense of auctioning its assets, and would have no effect on a debtor that, while too large to qualify as a small business debtor under the Bankruptcy Code, is small enough that applicable state law would not impose a market test. For large debtors such as Chrysler or GM, however, whether or not publicly traded,[17] the provision would grant any creditor with a claim that will not be paid in full a right to insist on the sort of process that state law would provide shareholders of a solvent firm. This process

[16] This term is defined by §101(51D) of the Bankruptcy Code.

[17] The proposed provision is designed to apply and to protect creditors in large, privately held firms just as it would apply to a publicly traded firm. The reference in the proposed provision to a "publicly traded" controlling interest is designed as a hypothetical test that would trigger the applicability of the provision; such tests are common in the Bankruptcy Code. A related provision might be desirable to define "publicly traded" for these purposes, though this term might be plain enough for courts to interpret in context.

would include, where appropriate, the right to insist on an openly contested auction with ample time for potential bidders to assess the assets on which they may bid.

Reliance on applicable state law—a common feature elsewhere in the Bankruptcy Code—would provide a debtor with the flexibility to opt out of an auction or other market test if exigent and unusual circumstances would allow a firm to opt out outside of bankruptcy. Yet, the provision would advantageously prevent a debtor from concluding a sale pursuant to a process that state law would disallow even if a bankruptcy judge believed, perhaps mistakenly, that the sale would be in the interest of the bankruptcy estate. That is, for a large firm, the bankruptcy sale process could not be more permissive than that required by applicable state law.

Finally, under no circumstance could the sale of a debtor's assets be conditioned on a bidder's willingness to assume some but not all of the debtor's liabilities. This practice is illegitimate, and was the crux of the problem in the Chrysler and GM cases.

Conclusion

There is a saying that one is cursed to live in interesting times. This quip—though trite from overuse and of uncertain origin—applies well to the Chrysler and General Motors bankruptcies. These cases, of iconic companies failing in the midst of a worldwide financial crisis, are no doubt interesting. But the law that they produced may be more curse than blessing. Time will tell.