No Big Deal: The GM and Chrysler Cases in Context

by

*Stephen J. Lubben**

INTRODUCTION

In the past summer, two historically important North American corporations – Chrysler and General Motors – filed chapter 11 cases to address their long-standing financial and operational difficulties. Both debtors were provided with substantial governmental financing from both Canada and the U.S.,[1] and both cases involved a quick sale of the "good" parts of the debtors' operating assets, while the remainder was left behind for liquidation.[2]

Almost every leading corporate bankruptcy academic has spoken against the automotive bankruptcy cases. And the Chrysler and GM chapter 11 cases have been vilified in every major finance-focused media outlet – by everyone from Ralph Nader[3] to Richard Epstein.[4] Why?

Many of the arguments against these cases, particularly those made in the press and by some of the participants in the cases, are hopelessly vague and amount, at heart, to a statement that the government should prefer investors over unions.[5] These are essentially political questions

*Daniel J. Moore Professor of Law, Seton Hall University School of Law. As always, Jennifer Ruth Hoyden made this article much better than it would have been.

[1] In the case of Canada, financial assistance came from both the federal and provincial (Ontario) governments.

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

[3] http://online.wsj.com/article/SB124355327992064463.html

[4] http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html

[5] http://www.bloomberg.com/apps/news?pid=20601039&refer=columnist_woolner&sid=aN_5hvV_xqHM
http://www.bloomberg.com/apps/news?pid=20601039&refer=columnist_woolner&sid=aN_5hvV_xqHM

Electronic copy available at: http://ssrn.com/abstract=1467862

that do not support their related arguments, including that these cases somehow violated the "rule of law."[6] The rule of law is not violated by a policy disagreement.

The academic critics of these chapter 11 cases make arguments that appear more credible. But they are not any more convincing upon close examination. For example, in his testimony before Congress,[7] Professor Douglas Baird argued that the bidding procedures approved by the courts in connection with the sale of both companies amounted to an impermissible, stealth reorganization plan because bidders were required to treat the unions in the same manner as the initial, government-sponsored bidder.

This might be true if there had been alternative bidders, but in the absence of any evidence of such a bidder, the bidding procedures are irrelevant. The bidding procedures could require a competitive bidder to stand on its head, but if there is no such bidder the procedures are purely academic. In a period when the credit markets have been essentially "closed,"[8] those who take for granted the existence of unknown or theoretical bidders have some obligation to explain how such a bidder would have bought GM, a company with $27 billion of *secured* debt.[9]

I use this short paper to contextualize what happened in these two chapter 11 cases and to address the key arguments against them. Stripped of their speculation and "what ifs," I show these academic arguments to be no more persuasive than the loose, unsupported arguments thrown about in the popular press.[10] But first, I show how these cases, and particularly their structure – a quick lender-controlled §363 sale[11] – are entirely within the mainstream of chapter 11 practice

---

6

7 Because of the newness of this issue, few academics have published formal articles on these issues. Instead, they have engaged these issues in the form of testimony and editorial writings, which I respond to herein.

8 http://www.ft.com/cms/s/0/8174765a-6058-11de-a09b-00144feabdc0.html

9 *See* In re General Motors Corp,, 407 B.R. 463, 484 (Bankr. S.D.N.Y. 2009) ("There are no merger partners, acquirers, or investors willing and able to acquire GM's business. Other than the U.S. Treasury and EDC, there are no lenders willing and able to finance GM's continued operations. Similarly, there are no lenders willing and able to finance GM in a prolonged chapter 11 case.").

10 For an example of the latter, see David Brooks, *The Quagmire Ahead,* N.Y. Times, June 1, 2009 (arguing that "the Obama plan rides roughshod over the current private investors").

11 11 U.S.C. § 363(b) (authorizing a trustee to sell property of the estate outside the ordinary course of business) & (f) (authorizing a sale free and clear of various interests). In a chapter 11 case, 11 U.S.C. § 1123(a)(5)(B) also authorizes sales under a reorganization plan. *See* text accompanying note 17 *infra*. When a sale occurs prior to confirmation of a plan, it is commonly referred to as a "§ 363 sale,"

Electronic copy available at: http://ssrn.com/abstract=1467862

for the last decade.[12]

Congress may well decide, as a matter of policy, that this should end, but until it does there is little to the idea that these cases are "unprecedented" in their structure.[13] The identity of the DIP lender is novel,[14] but what happened is routine.[15] And the identity of the lender is not a bankruptcy issue.

I. MODERN CHAPTER 11 PRACTICE: ASSET SALES BEFORE PLANS

There are two sections of the Bankruptcy Code applicable in chapter 11 that explicitly authorize the sale of property. Section 363(b) authorizes a trustee, and thus the chapter 11 debtor in possession,[16] to sell property of the estate outside the ordinary course of business.[17] And § 1123 provides that a chapter 11 plan may include provisions for sale of all or any part of the property of the estate.[18] The latter course presupposes the drafting of a complete plan and disclosure statement, creditor voting, and a confirmation hearing.[19] Section 363 sales are thus usually much faster alternatives, and the Bankruptcy Code itself

and this article uses that common terminology to distinguish a sale outside the plan confirmation context.

[12] Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 Stan. L. Rev. 673, 674 (2003). *See also* Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc., 128 S. Ct. 2326, 2331 n.2 (2008).

[13] http://www.msnbc.msn.com/id/30507066/ (quoting Professor Skeel). In this article Skeel argues that government's role in the case is unprecedented in bankruptcy history, a contention which seems to neglect the Penn Central case in the 1970s. *See* In re Penn Central Transportation Co., 596 F.2d 1127, 1149 (3d Cir. 1979) ("The sheer size of the expenses of administration, the unprecedented scope and number of compromises preceding adoption of the Plan, and legislative intervention are all factors which require a unique approach . . . .").

[14] 11 U.S.C. §364 (authorizing post-petition or "DIP" lending). In chapter 11, the debtor retains possession or control of its bankruptcy estate, because no trustee is appointed, and is referred to as the "debtor in possession" or the "DIP." 11 U.S.C. §1107(a). *See* David A. Skeel, Jr., *The Past, Present and Future of Debtor-In-Possession Financing*, 25 Cardozo L. Rev. 1905, 1920-29 (2004).

[15] Rachael M. Jackson, Comment, *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, 452 (2005).

[16] 11 U.S.C. §1107(a).

[17] John J. Hurley, *Chapter 11 Alternative: Section 363 Sale of all of the Debtor's Assets Outside a Plan of Reorganization*, 58 Am. Bankr. L.J. 233, 24-41 (1984) (Noting more than twenty years ago, that "it has become generally accepted that section 363(b) empowers a trustee or debtor in possession to sell all of the property of the debtor outside a plan of reorganization.").

[18] 11 U.S.C. §1123(b)(4).

[19] *Cf.* Timothy D. Cedrone, *A Critical Analysis Of Sport Organization Bankruptcies In The United States And England: Does Bankruptcy Law Explain The Disparity In Number Of Cases?,* 18 SETON HALL J. SPORTS & ENT. L. 297, 310-12 (2008) (explaining the chapter 11 plan process).

Electronic copy available at: http://ssrn.com/abstract=1467862

provides no guidance on when either procedure should be used.[20]

To prevent abuse of the § 363 process, courts have developed rules that prevent imposition of a reorganization plan through the sale process.[21] This is the so-called rule against "*sub rosa*" plans – that is, plans disguised as sales.[22] While all Circuits seem to follow the rule against covert plans, the precise content of the rule varies by Circuit.[23] For example, in the Second Circuit the rule seems to be a subpart of that jurisdiction's larger requirement that a pre-plan sale be supported by a good business justification.[24] Shortcutting the Bankruptcy Code is not a business justification, good or otherwise, and thus does not justify a pre-plan sale.[25]

At the other end of the spectrum, the Fifth Circuit seems to have adopted a sense of the rule against disguised plans as requiring pre-plan sales to comply with the Bankruptcy Code's rules for plan confirmation, particularly when all of the debtor's assets are being sold.[26] The Second Circuit, on the other hand, has expressly rejected this equivalence, and has held that a pre-plan settlement can even violate the "absolute priority rule"[27] if the debtor puts forth a sufficiently compelling business justification.[28] In short, until the

[20] *See* J. Vincent Aug et al., *The Plan of Reorganization: A Thing of the Past?*, 13 J. Bankr. L. & Prac. 3, 4-5 (2004) ("A Section 363 sale is generally the preferred method for selling assets because it is quicker and less expensive, and provides a quick fix to address continuing losses, rapidly depleting assets, and loss of cash flow.").

[21] Jason Brege, *An Efficiency Model of Section 363(b) Sales*, 92 Va. L. Rev. 1639, 1650 (2006).

[22] The phrase was first used in In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983), but seems to add little to the discussion.

[23] James J. White, *Death and Resurrection of Secured Credit*, 12 Am. Bankr. Inst. L. Rev. 139, 161-63 (2004).

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

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

[26] *See, e.g.,* In re Babcock and Wilcox Company, 250 F.3d 955 (5th Cir. 2001); In re Continental Air Lines, Inc. 780 F.2d 1223 (5th Cir. 1986); *see also* In re Gulf Coast Oil Corp., 404 B.R. 407 (Bankr. S.D. Tex. 2009).

[27] The rule that each layer of debt be paid in full, starting with the most senior debt, before any junior claim receives any recovery. *See generally* Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. Chi. L. Rev. 738 (1988).

[28] Motorola, Inc. v. Official Comm. of Unsecured Creditors and J.P. Morgan Chase Bank, N.A. (In re Iridium Operating LLC), 478 F.3d 452, 466 (2d Cir. 2007). To be sure, *Iridium* involved a settlement under FRBP 2019, and it is unclear whether the flexibility shown in the case should be extended to a straightforward absolute priority analysis, where the parties' relative positions are uncontested. On the other hand, the *Iridium* court declined to adopt the holding of Official Unsecured Creditors' Comm. v. Stern (In re SPM Mfg. Corp.), 984 F.2d 1305, 1307, 1312 (1st Cir. 1993), which allows senior lenders to "gift" recoveries to lower classes, because of the dispute in

Supreme Court or Congress weighs in on this matter, the location of the chapter 11 cases can have some bearing on the law applied in the case.[29]

Once a debtor in possession elects to sell its assets in a § 363 sale, the process typically involves indentifying an initial bidder, frequently called a "stalking horse," and approval of bidding procedures.[30] These bidding procedures provide structure for the solicitation of competing bids, followed by an auction if any competing bids materialize.[31] Throughout the process it is widely recognized that the bankruptcy courts have wide discretion in structuring sales of estate assets,[32] and prospective purchasers are often counseled to expect a "malleable" process.[33]

In particular, the ultimate goal is maximizing the value of the estate, to increase the return to creditors.[34] Thus, there is substantial caselaw to support the notion that "non-conforming" bids must be considered by bankruptcy courts if doing so will increase the return to creditors.[35]

A. EVOLUTION OF THE CURRENT § 363 SALE PROCESS.

For much of the early years of the Bankruptcy Code and chapter 11, § 363 sales were of limited interest. Indeed, a review of the many cases in Lynn LoPucki's Bankruptcy Research Database[36] shows that only about a half-dozen cases before 1995 involved important § 363 issues.[37] But in the past ten to fifteen years, secured lenders have used

Iridium over the lenders' liens. Thus, if the holding of *Iridium* does not apply, *SPM* still might.

[29] *Cf.* Stephen J. Lubben, *Delaware's Irrelevance,* 16 A.B.I. L. Rev. 267 (2008).

[30] *See* In re O'Brien Environmental Energy, Inc., 181 F.3d 527, 530 (3rd Cir. 1999).

[31] *See* C.R. Bowles & John Egan, *The Sale of the Century or a Fraud on Creditors?: The Fiduciary Duty of Trustees and Debtors in Possession Relating to the "Sale" of a Debtor's Assets in Bankruptcy*, 28 U. Mem. L. Rev. 781, 805-36 (1998).

[32] In re Financial News Network, Inc., 980 F.2d 165, 169 (2d Cir. 1992) (holding that the Bankruptcy Court may consider additional evidence pertaining to a bid after the official close of bidding, stating that "we have observed that '[f]irst and foremost is the notion that a bankruptcy judge must not be shackled with unnecessarily rigid rules when exercising the undoubtedly broad administrative power granted him under the [Bankruptcy] Code"') (quoting In re Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983)).

[33] In re Food Barn Stores, Inc., 107 F.3d 558, 565 (8th Cir. 1997).

[34] In re Chung King, Inc., 753 F.2d 547, 549 (7th Cir. 1985).

[35] *See, e.g.*, Corp. Assets, Inc. v. Paloian, 368 F.3d 761 (7th Cir. 2004); In re Financial News Network, Inc., 126 B.R. 152 (S.D.N.Y. 1991); In re Wintex, 158 B.R. 540 (D. Mass 1992); In re Edwards, 228 B.R. 552 (Bankr. E.D. Pa. 1998).

[36] http://lopucki.law.ucla.edu/

[37] A complete list of cases is attached as Appendix A to my testimony before the TARP Congressional Oversight Panel, available at http://cop.senate.gov/hearings/library/hearing-072709-detroithearing.cfm.

this provision, plus the control inherent in being a secured lender – particularly control over the debtor's cash[38] — to take charge of chapter 11 cases.[39] Among the well-known debtors that have used § 363 sales are TWA, Vlasic Foods, Polaroid and Bethlehem Steel.[40] Just this year, § 363 sales have been used to reorganize several retailers including Eddie Bauer,[41] Filene's Basement,[42] and Ritz Camera.[43]

In the new world of sale-driven chapter 11 cases, the secured lender drives the process by the simple fact that it has no obligation to fund the debtor's reorganization attempts, and thus funding will be provided only if it also benefits the controlling lender.[44] The lenders are willing to fund a quick sale because § 363 provides a better mechanism for selling assets than state foreclosure law.[45]

Other secured lenders are protected from "low ball" sales by their ability to credit bid their claims,[46] and take over control of the collateral.[47] Other creditors who think the sale price is too low can orchestrate a competing bid. Once the sale is completed, the creditors are further protected during the distribution of the sale proceeds by the normal rules of chapter 11, including rules governing priority of distribution such as §§ 502, 507 and 726 (made applicable to a chapter 11 plan by § 1129(a)(7)) and, upon objection of an impaired class of unsecured creditors, the absolute priority rule[48] and the rule against

[38] Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. Pa. L. Rev. 1209, 1229 (2006).

[39] Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy,* 82 Tex. L. Rev. 795 (2005).

[40] *Cf.* Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 Mich. L. Rev. 1 (2007).

[41] In re Eddie Bauer Holdings, Inc., et al., Case No. 09-12099 (Bankr. D. Del. 2009).

[42] In re Filene's Basement, Inc., et al., Case No. 09-11525 (Bankr. D. Del. 2009).

[43] In re Ritz Camera Centers, Inc., Case No. 09-10617 (Bankr. D. Del. 2009).

[44] Baird & Rasmussen, Missing Lever, *supra* note 38, at 1239-40. *See also* In re Decora Indus., 2002 WL 32332749, at *3 (D. Del. May 20, 2002).

[45] *See* In re Trans World Airlines, Inc., 322 F.3d 283, 288-90, 293 (3d Cir. 2003).

[46] In Chrysler, where the ability to credit bid was most relevant, the dissenting lenders had no independent right to credit bid, indeed they were arguably not even secured creditors when acting independently. Instead, all of the security interests in this loan were held by a collateral trustee, for the benefit of all lenders. Under the loan documents, the trustee was instructed to take orders from the agent bank upon default – Chase. At the Chrysler sale hearing, the government testified that Chase had been told it could credit bid if it did not like the deal. The dissenting lenders, representing less than 5% of the total loan, had no right under the load documents to override Chase's decision in this regard. The government certainly could have explained this before the sale hearing, as the apparent inability to credit bid appeared to represent a problem with these cases. http://www.creditslips.org/creditslips/2009/05/chrysler-credit-bidding-again.html.

[47] *See* Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 121-22 (1991).

[48] 11 U.S.C. §1129. *Cf.* John D. Ayer*, Rethinking Absolute Priority After Ahlers,* 87 Mich. L. Rev. 963, 969-70 (1989).

"unfair discrimination," which applies to all creditors.[49]

The drawn-out, debtor-controlled chapter 11 process of Eastern Airlines and Pan Am is long gone.[50] Whether this is a good thing is open to debate, but it clearly reflects current reality[51] and creditor preference.[52] Moreover, the 2005 Amendments to the Bankruptcy Code, which increased the difficulty of pursuing a traditional chapter 11 reorganization plan arguably suggest a Congressional "push" in favor of quicker, sale-driven chapter 11 cases.[53]

B. STRUCTURE OF THE GM AND CHRYSLER SALES.

With regard to the cases at issue, the structure of the two automotive cases was quite similar, and it bears discussing the two in tandem.

In both cases, the U.S. Treasury and the governments of Canada and Ontario agreed to provide the automakers with DIP financing on the condition that a sale of each debtor's assets occur on an expedited basis so as to preserve the value of the business, restore consumer confidence, and avoid the costs of a lengthy chapter 11 process.[54] In both cases the purchaser of the assets was a newly created entity, funded by the North American governments. In exchange for wage cuts that brought the automakers in line with their foreign competitors, and the union's promise not to strike for several years, the purchasers agreed to give equity stakes in the reorganized company to the UAW's retiree health care trust, called the Voluntary Employee Beneficiary Association (VEBA), .

In Chrysler, a subsidiary of Fiat received twenty percent of the purchaser's equity, with the right to acquire up to an additional thirty one percent of the equity over seven years, in exchange for providing

[49] Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 Am. Bankr. L.J. 227, 228 (1998).

[50] Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy,* 55 Stan. L. Rev. 751, 751 (2002) ("Corporate reorganizations have all but disappeared. Giant corporations make headlines when they file for Chapter 11, but they are no longer using it to rescue a firm from imminent failure. Many use Chapter 11 merely to sell their assets and divide up the proceeds.").

[51] Stephen J. Lubben, *The "New and Improved" Chapter 11*, 93 Ky. L.J. 839, 841 - 42 (2005) ("[I]t is not clear that this development promotes social welfare. Rather, lender control may only benefit lenders.").

[52] Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt*?, 47 B.C. L. Rev. 129, 156-57 (2005).

[53] Lubben, Stephen J., Systematic Risk & Chapter 11 (May 4, 2009). Temple Law Review, 2009; Seton Hall Public Law Research Paper No. 1399015. Available at SSRN: http://ssrn.com/abstract=1399015.

[54] Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC), 576 F.3d 108, 112 (2d Cir. 2009).

reorganized Chrysler with access to competitive fuel-efficient vehicle platforms and distribution capabilities in growth markets.[55] The debtor's key assets were transferred to the purchaser in exchange for $2 billion in cash and the assumption of the collective bargaining agreement, modified as described. Before bankruptcy Chrysler owed about $6.9 billion to its prepetition first lien lenders, under a loan agreement that appointed J.P. Morgan Chase as agent to represent the collective interests all creditors under the credit line. About ninety two percent of Chrysler's senior lenders supported the government's plan with Fiat, according to Chase.[56] Nevertheless certain Indiana pension funds, which held about $42.5 million of the $6.9 billion secured debt, or less than one percent of the total, filed an objection to the sale motion.

The Indiana funds raised a variety of objections, including an argument that the overall structure constituted an disguised plan, but faced the inconvenient reality that they had contractually given up their right to independent action.[57] In particular, under section 6.12 of the Chrysler collateral agreement, Chase, as agent, had the power to release the liens granted under the loan agreements. Indeed, upon default the agent had full control over any "Collection Enforcement Action," defined to include "exercising any other right or remedy under the [UCC] . . . or under any Bankruptcy Law or other applicable law." Accordingly, while also rejecting the funds' arguments on the merits, the bankruptcy court also ruled that that the Indiana funds had "contracted away their right to act inconsistently" with the actions of Chase as agent, and thus the Funds lacked standing to advance their objections.[58]

In GM, the process followed the same basic design, but with the non-governmental secured lenders being paid in cash and the debtor otherwise receiving 10% of the equity in the reorganized company, plus warrants to purchase up to 15% more equity under certain conditions.[59] Presumably the equity and warrants will be distributed to unsecured creditors, including GM bondholders, as part of a

[55] In re Chrysler LLC, 405 B.R. 84, 92 (Bankr. S.D.N.Y.), *aff'd,* 576 F.3d 108 (2nd Cir. 2009).

[56] http://www.reuters.com/article/euPrivateEquityNews/idUSTRE54O4M320090526

[57] *See* Beal Sav. Bank v. Sommer, 865 N.E.2d 1210 , 1216(N.Y. 2007) ("[L]anguage in the agreements confirms that the Lenders contemplated unified action by the Administrative Agent. The Agent does not perform merely mechanical or technical functions but rather has a broad grant of power.").

[58] In re Chrysler LLC, 405 B.R. 84, 104 (Bankr. S.D.N.Y.), *aff'd*, 576 F.3d 108 (2d Cir. 2009).

[59] In re General Motors Corp,, 407 B.R. 463, 482-83 (Bankr. S.D.N.Y. 2009).

liquidating plan. As in Chrysler, the bankruptcy court rejected arguments by dissident unsecured bondholders that the sale constituted an impermissible *sub rosa* plan, ruling that the sale "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."[60] The court then concluded that the "objectors' real problem is with the decisions of the Purchaser, not with the Debtor."[61]

In short, the basic structure used to reorganize both GM and Chrysler was not unprecedented. Indeed, it was entirely ordinary.[62] In both cases the "good" assets were sold to new entities.[63] The consideration for that sale goes to the "old" debtor, and will be distributed according to the absolute priority rule. None of this constitutes a covert reorganization plan or a corruption of the bankruptcy process.[64]

The notion that the speed of these cases was unique, or that the use of § 363 to effectuate a quick sale was novel, is therefore without merit.[65] As Judge Gonzalez noted in Chrysler, "[t]he sale transaction . . . is similar to that presented in other cases in which exigent circumstances warrant an expeditious sale of assets prior to confirmation of a plan. The fact that the U.S. government is the primary source of funding does not alter the analysis under bankruptcy law."[66]

Of course the academic critics of theses cases have largely avoided this line of argument. Since many of the critics were among those to first discuss the new face of chapter 11 in an academic setting,[67] and were generally supportive of the new order,[68] or have otherwise long argued for chapter 11 to move away from traditional reorganizations in

[60] *Id*. at 495-96.

[61] *Id.* at 496.

[62] Douglas R. Baird, *The New Face of Chapter 11*, 12 Am. Bankr. Inst. L. Rev. 69, 80-82 (2004).

[63] *Cf.* In re Dial-A-Mattress Operating Corp., 2009 Bankr. LEXIS 1801 (Bankr. E.D.N.Y. June 24, 2009) (approving 363 sale to newly created corporation).

[64] *See* In re Trans World Airlines, Inc., 2001 Bankr. LEXIS 980, 2001 WL 1820326, *11 (Bankr. D. Del. Apr. 2, 2001).

[65] Indeed, the Lehman Brothers sale was completed in even less time, with no government involvement. Stephen J. Lubben, *The Sale of the Century and Its Impact on Asset Securitization: Lehman Brothers*, 27 Am. Bankr. Inst. Journal No. 10, page 1 (2009).

[66] In re Chrysler LLC, 405 B.R. 84, 87 (Bankr. S.D.N.Y.), *aff'd,* 576 F.3d 108 (2nd Cir. 2009).

[67] *E.g.*, David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. Pa. L. Rev. 917, 935-38 (2003).

[68] Barry E. Adler, *Bankruptcy Primitive*s, 12 Am. Bankr. Inst. L. Rev. 219, 224-25 (2004).

favor of market-based solutions, it could hardly be otherwise.[69] In the next part of this paper I address the more specific arguments that these leading scholars have made in the press and before Congress and the TARP Congressional Oversight Panel.

II. THE ACADEMIC ARGUMENTS

In this section I address the arguments that bankruptcy academics have made against the automotive bankruptcies. These arguments are generally more sophisticated than those presented in the cases themselves, yet I contend they still suffer from serious flaws. I make little effort to engage the criticisms mounted by non-bankruptcy legal academics, like Professor Richard Epstein, a well-known torts expert at the University of Chicago Law School.[70] As part of his critique of these bankruptcy cases, Professor Epstein notes that President Obama is "no bankruptcy lawyer."[71] The same, of course, can be said for Professor Epstein – and the suggestion that the President personally negotiated these cases is silly.[72] More generally, I have previously argued that many of these critiques of the chapter 11 cases show little understanding of how chapter 11 works.[73] The following arguments suffer from no such deficiencies.

A. BIDDING PROCEDURES AND "SUB ROSA" PLANS (DOUGLAS BAIRD)

In his recent testimony before the House Subcommittee on Commercial and Administrative Law,[74] Professor Baird advanced a neat argument that the bidding procedures approved in the automotive cases so "locked in" a particular deal that they amounted to a plan of reorganization, in violation of the caselaw discussed in the prior section of this paper.

In both automotive cases, the approved bidding procedures provided that to become a "Qualified Bidder" a bidder must agree to assume the same collective bargaining agreements that the initial

[69] *See* Barry E. Adler & Ian Ayres, *A Dilution Mechanism for Valuing Corporations in Bankruptcy*, 111 Yale L.J. 83, 101-03 (2001); Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 Colum. L. Rev. 527, 559 (1983).

[70] http://www.law.uchicago.edu/faculty/epstein

[71] http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html

[72] The full quote is "President Obama—no bankruptcy lawyer—twisted the arms of the banks that have received TARP money to waive their priority." *Id.* As I discuss *infra*, the "strong arming" argument is a contention without any supporting evidence.

[73] http://www.creditslips.org/creditslips/2009/06/the-absolute-priority-rule.html

[74] http://judiciary.house.gov/hearings/pdf/Baird090722.pdf

bidder intended to assume. Because this requirement could have led a bidder to offer less cash for the debtors' assets – since it would have been forced to assume this additional liability – Baird argues that the process became "both a sale and a *sub rosa* plan."[75]

The requirement in the bidding procedures that any bidder assume the UAW agreements smacks of overreaching. But was another bidder willing to pay more than $2 billion for Chrysler's assets or otherwise top the proffered bids, if it could do so without assuming the UAW contracts? I doubt it, and if not the bidding procedures are irrelevant.

A bidding procedure that only applies to competing bidders is a dead letter if there are no competing bidders – the terms of the bidding procedures are no more relevant than the instructions for inflating a life vest on a plane you will never fly on. The dissenting Chrysler lenders[76] and some academic commentators[77] have argued that the bidding procedures may have deterred an unknown bidder, thus undermining the process.

The deterrence argument presumes that the procedures have more "stickiness" than they actually do. As noted in Part I, the caselaw is abundant and clear that bankruptcy courts have an obligation to consider the highest bid presented, even if it does not conform with previously approved bidding procedures.[78] Any investor who contemplates buying a multi-billion dollar distressed corporation will be advised by experienced bankruptcy counsel who know this – the contrary presumption is not credible.

Irrespective of the potential effects of the bidding procedures, there are good independent reasons to think that there were no inhibited bidders who failed to appear. The automotive industry, both domestic and foreign, is presently heavily distressed. At the same time, the credit markets show no ability to provide the kind of financing that would be needed to purchase either GM or Chrysler.[79]

And why should we not trust the market information that is available to us? The senior lenders – who could have "credit bid" their claims[80] – showed no interest in taking on these assets. Chrysler had been trying to sell itself for months before the chapter 11 case, with no

[75] Testimony at page 5.

[76] http://www.forbes.com/feeds/afx/2009/05/05/afx6380833.html

[77] For example, Mark Roe in the commentary I discuss, *infra*.

[78] *See* text accompanying notes 32 – 35, *supra.*

[79] http://www.ft.com/cms/s/0/33dbf8a6-82a3-11de-ab4a-00144feabdc0.html

[80] That is, forgiven their debt in exchange for the companies' assets. 11 U.S.C. §363(k).

success at all.[81] And recall that in 2007, a time of easy credit and stable markets, Daimler essentially paid somebody to take Chrysler off its hands.[82] This does not suggest a group of assets with a lot of hidden value.

Professor Baird acknowledges the theoretical nature of his concern,[83] but still worries that the bankruptcy court could have done more. It is doubtful that such a move would have had any purpose, and thus seems to be an argument for more window dressing.

B. PLAN-SALE EQUIVALENCE (BARRY ADLER)

In his remarks before the TARP Congressional Oversight Panel hearing in Detroit this past July,[84] Professor Adler argued

> that Chapter 11 contains rules 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.[85]

Adler goes on to argue that the requirements of chapter 11 – particularly the "fair and equitable" and "no unfair discrimination" provisions of § 1129(b) – should have been applied to protect the interests of senior creditors.

There are two problems with this analysis. First, this is not the law in the Second Circuit, where both GM and Chrysler's cases were filed. As previously discussed in Part I, the Second Circuit has never held that § 363 sales are subject to the full requirements of the chapter 11 plan confirmation process, and has affirmatively held that one key part of §1129(b), the absolute priority rule, can be ignored outside of the confirmation context when there is a suitable justification.[86] In short, Adler's position is a fair statement of the law of the Fifth Circuit, and there could be good arguments for why this is what the law in the Second Circuit *should* be, but it hardly seems fair to fault a bankruptcy court for following the (binding) opinions issued by its own Circuit Court.

---

81 http://www.bloomberg.com/apps/news?pid=20601103&sid=aCWc52_2KMYs&refer=us

82 http://business.timesonline.co.uk/tol/business/industry_sectors/engineering/article1786611.ece

83 Testimony at pages 5-6.

84 http://cop.senate.gov/documents/testimony-072709-adler.pdf

85 Testimony at page 4 (discussing the Chryslers case).

86 Motorola, Inc. v. Official Comm. of Unsecured Creditors and J.P. Morgan Chase Bank, N.A. (In re Iridium Operating LLC), 478 F.3d 452, 466 (2d Cir. 2007).

More importantly, Adler has to rely on conjecture even to invoke the provisions of § 1129(b). As he notes, the tests he points to are class protections that are only applicable if the class in question rejects the debtor's plan.[87] Given that more than 90% of the Chrysler lenders supported the transaction, the reasons for imagining this class rejecting the plan are somewhat unclear.

Professor Adler argues "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."[88] This, he argues, means that the lenders would have to be split into two classes, giving the non-TARP parties a means of rejecting the plan and invoking § 1129(b).[89]

There are three problems with Adler's argument. First, after extensive discovery and depositions, there is still no evidence to support the claim that the TARP lenders were bullied into accepting the proffered deal in Chrysler. In other contexts, like that of home mortgage modifications and proposed legislation for consumer financial protection and to regulate previously unregulated assets such as derivatives or market participants such as private hedge funds, it appears that some of the biggest recipients of TARP funds have been the ones least likely to bend to Administration policy.[90] And if these lenders were not "beholden" to the Treasury, the entire argument evaporates.

Second, the dissenting creditors in Chrysler were quite forceful in noting that the were *secured*. Although the "fair and equitable" rule of § 1129(b)(1) applies to a dissenting class of secured creditors,[91] the partially codified absolute priority rule of § 1129(b)(2)(B) does not apply to a class of secured creditors.[92] Instead, under § 1129(b)(2)(A)(i), a dissenting class of secured creditors must receive the present value of its collateral – which once again spotlights the Indiana Funds' failure to present any contrary valuation evidence.

[87] 11 U.S.C. §1129(b)(1) ("if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if . . . "); *see also* 11 U.S.C. §1129(a)(8) (requiring all classes to accept the plan).

[88] Testimony at page 5 (emphasis added).

[89] *See* G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Unresolved Doctrines of Classification and Unfair Discrimination in Business Reorganizations Under the Bankruptcy Code*, 55 Bus. Law. 1, 24-32 (1999).

[90] http://www.bloomberg.com/apps/news?pid=20601103&sid=a7kYntqozaKo

[91] E.g., *In re D&F Construction, Inc.*, 865 F.2d 673, 676 (5th Cir. 1989).

[92] *In re* Arden Properties, Inc., 248 B.R. 164, 173-74 (Bankr. D. Az. 2000).

Alternatively, under § 1129(b)(2)(A)(ii) and its incorporation of § 363(k), the dissenting secured creditor is protected upon a sale by being permitted to credit bid.

Third, even if the differing interests of non-TARP recipients would have required them to be separately classified from the TARP recipients,[93] there is no Code or case law authority that this separate classification would also supersede the contractual right of Chase to cast the vote on behalf of the non-TARP lenders.

As for the GM case, the dissenting bondholders were unsecured, and thus potentially entitled to engage the absolute priority rule under § 1129(b)(2)(B). But only if the unsecured creditors, as a class, rejected the plan. Whether the unsecured creditors would have rejected a hypothetical GM plan is unclear, given that a majority (in face amount) of the bondholders was supportive.[94]

More importantly, there was no absolute priority violation because there was no payment being made to a junior class – the shareholders were to receive nothing. The dissenting bondholders had a possible "unfair discrimination" argument, if we accept that the payments to the UAW VEBA were disguised payments on account of the union's unsecured claims, something that the bankruptcy courts rejected.[95] Even then, the UAW claims likely could have been separately classified from the bondholders, especially given the labor concessions obtained by the reorganized debtors.[96] And in the Second Circuit, separate classification and discrimination in favor of workers whose ability to strike could destroy a reorganization may constitute "fair" discrimination.[97]

It has to be remembered that all of the key players in these cases were highly sophisticated. GM's board – represented by Cravath,

[93] Although most courts have concluded that § 1122 requires classification be based on the nature of the claims rather than on the nature or interests of the holders of the claims, there is Second Circuit authority suggesting that the interests of the claim holder may provide a basis for separate classification. *In re Chateaugay Corp.*, 89 F.3d 942 (2d Cir. 1996).

[94] http://www.nytimes.com/2009/05/31/business/31gm.html

[95] 11 U.S.C. §1129(b)(1).

[96] In re Kliegl Bros. Universal Electric Stage Lighting Co., 149 B.R. 306, 309 (Bankr. E.D.N.Y. 1992) (allowing separate classification and treatment of union claim); *see also* In re Coram Healthcare, Corp., 315 B.R. 321, 349 (Bankr. D. Del. 2004) ("Numerous courts have held that separate classification and treatment of trade claims is acceptable if the separate classification is justified because they are essential to a reorganized debtor's ongoing business."); Markell, *Unfair Discrimination in Chapter 11*, *supra* note 49, at 241.

[97] *In re Chateaugay Corp.*, 89 F.3d 942 (2d Cir. 1996).

Swaine & Moore – is hardly a group to be easily cowed by some hard bargaining. And Chrysler's senior lenders had agreed by contract to have JPMorgan Chase, the lead lender, negotiate on their behalf.[98] We would have heard if Jamie Dimon felt Chase was being strong-armed into supporting the sale – he's not known to be shy.[99]

Likewise, it was entirely rational for the bulk of Chrysler's secured lenders to believe that $2 billion in cash, on their $6.9 billion claim, was, by far, the highest possible recovery they could obtain. Indeed, a nearly 30% recovery is clearly better than these lenders could have done if they had liquidated the debtor's assets. And liquidation was the lenders' only real alternative.

While commentators often imply that liquidation is a costless endeavor, liquidating a company the size of Chrysler would have cost millions of dollars. Liquidation would thus only make sense if the lenders could be sure to recover more than $2 billion *plus* the costs of liquidation. Given the distressed state of the automotive industry, and the attendant effects this reality had for the value of Chrysler's assets, the lenders no doubt saw the wisdom of a risk-free $2 billion.

C. A RETURN TO THE (BAD) OLD DAYS? (DAVID SKEEL)

In testimony before Congress,[100] and as more fully explained in an article written for the American Enterprise Institute,[101] David Skeel has argued that the automotive cases represent a resurrection of the worst features of corporate reorganization from 100 years ago. In particular, Professor Skeel argues that the sale transaction in both automotive cases amounted to the kind of "sham" sale that was once a common feature of railroad receiverships, a type of corporate reorganization Congress ended in the New Deal by federalizing corporate bankruptcy.[102]

Skeel is undoubtedly correct that railroad receiverships involved

[98] As noted, *supra*, under section 6.12 of the Chrysler collateral agreement, Chase, as agent, has the power to release the liens granted under the loan agreements. Indeed, upon default the agent has full control over any "Collection Enforcement Action," defined to include "exercising any other right or remedy under the [UCC] . . . or under any Bankruptcy Law or other applicable law." This is not a problem created by TARP, the Bankruptcy Code, or the federal government, but by the loan agreement to which the lenders themselves voluntarily agreed to be bound.

[99] http://www.businessweek.com/careers/managementiq/archives/2008/10/ceos_on_the_cou.html

[100] http://judiciary.house.gov/hearings/pdf/Skeel090521.pdf

[101] http://www.american.com/archive/2009/may-2009/why-the-chrysler-deal-would-horrify-a-new-dealer

[102] DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 48-70 (2001).

stylized sales of the railroad's assets,[103] but he is wrong to identify that as the key problem with the receiverships.[104] Indeed, Professor Skeel himself previously explained that the problem with receiverships was that

> [t]he Wall Street professionals who organized protective committees in order to negotiate the reorganization seemed to focus more on obtaining generous fees for themselves than on striking a good bargain on behalf of the scattered investors whom they purported to represent. The big losers, of course, were small, individual investors.[105]

In addition, the process was generally designed to "squeeze out" small unsecured creditors, benefiting the shareholders (who were typically large institutions) and management.[106] None of this really has much to do with the sale structure in the automotive cases.

And it clearly is not Professor Skeel's primary concern either – instead the receivership analogy simply serves as a frame for his larger arguments that the automakers assets were undervalued and that the structure of the sale process unduly favored the unions over other creditors.[107]

But in neither case were the objecting creditors able to produce any credible evidence that the debtors were worth more than was being paid, and in fact the evidence presented suggested that strategy promoted by the Automotive Task Force was all that stood between these investors and a substantially lower recovery.[108] In addition, before presuming that these cases were some sort of intrigue to buy the

[103] In particular, receiverships involved the initiation of a foreclosure action by a secured lender, the credit bid by that secured lender of its claim, and the transfer of the debtor's assets to a new shell corporation, capitalized as agreed by the prior holders of the debtor's securities. EDWARD SHERWOOD MEAD, CORPORATION FINANCE 406-12 (rev. ed. 1920) (describing the process used to commence a receivership).

[104] *See* Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 Cornell L. Rev. 1420, 1445-51 (2004).

[105] David A. Skeel, Jr., *Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship*, 113 Harv. L. Rev. 1075, 1089 (2000)(footnote omitted).

[106] Stephen J. Lubben, *Out of the Past: Railroads & Sovereign Debt Restructuring*, 35 Geo. J. Int'l L. 845, 850 (2004). *See also* In re Wabash Valley Power Ass'n, 72 F.3d 1305, 1314 (7th Cir. 1995) ("In its origins, the absolute priority rule was a judicial invention designed to preclude the practice in railroad reorganizations of "squeezing out' intermediate unsecured creditors through collusion between secured creditors and stockholders (who were often the same people).").

[107] This is particularly clear from the American Enterprise Institute paper, *supra* note 101.

[108] *See* In re Chrysler LLC, 405 B.R. 84, 105-06 (Bankr. S.D.N.Y.), aff'd), *aff'd,* 576 F.3d 108 (2nd Cir. 2009).

automakers' assets on the cheap, it once again bears looking at the available market information. For example, the dissenting Chrysler lenders – the Indiana pension funds – paid $17 million for their stake in the senior debt that had a face value of $43 million. They received $15 million through the Chrysler bankruptcy process.[109] That is, their claim was paid at more than 88% of its market value, measured at the time the funds bought their claim. If the market price was roughly accurate, then the notion that the purchaser underpaid for Chrysler's assets falls apart.

And if the purchaser did not underpay for the assets, then the idea that the bankruptcy court should concern itself with the companies' post-sale transactions with the unions also becomes suspect. The UAW is getting better treatment than other unsecured creditors. But that better treatment is not coming from the debtor. It is coming from the government, passing through the purchaser of the "good" assets in each case, supported by new labor concessions from the UAW. Asset buyers have no obligation to buy anything more than they want to buy, and no obligation to absorb any claims other than those the buyer feels it needs to operate the purchased assets.

We can debate whether it is wise for the government to bail out the UAW, but it does not implicate the bankruptcy process *unless* this bail out is being funded by value that should have gone into the debtors' estates. But if the assets were not undervalued, Skeel's argument that the funds going to the unions should have instead gone into the estates amounts to little more than a claim that the buyers (and thus the U.S. and Canadian governments) should have overpaid for the debtors' assets.[110]

D. GOVERNMENT OVERINVESTMENT AND THE BIDDING PROCEDURES, AGAIN (MARK ROE).

In a recent editorial in *Forbes*,[111] Mark Roe criticizes the government's decision to "flood[] Chrysler with money on non-commercial terms" and argues that the results in that case should not be taken at face value since "there was a market test here, but in form only, because the bidding was for the proposed plan." The first claim accuses the government of overinvestment in the automakers, the second reanimates the argument that the bidding procedures mattered

[109] http://www.creditslips.org/creditslips/2009/06/what-did-the-indiana-funds-want.html

[110] Or, alternatively, that the creditors should have received a bailout too – a policy question, and not one that demonstrates a violation of the Bankruptcy Code or the "rule of law."

[111] http://www.law.harvard.edu/news/2009/06/15_roe.html

in these cases.

It is not clear that the overinvestment argument is a bankruptcy issue; rather, it seems like another way of saying that Professor Roe does not agree with the Administration's policy choices. It is also not clear that it is an issue confined to government as DIP lender. Most DIP financing comes from the debtor's pre-petition lender,[112] and while these loans are often individually profitable, one might also wonder if there were not many cases of overinvestment by banks looking to postpone the consequences of an earlier lending mistake. Moreover, while Roe characterizes the automotive cases as an example of the government propping up defective companies, that alone does not tell us if the move was rational or socially efficient. For example, if the government faced an even greater cost upon liquidation of the debtors through unemployment payments, unpaid environmental cleanup costs, and other analogous expenses, providing bankruptcy financing to these debtors was the right move.[113] Indeed, unlike a private lender who can largely ignore these costs since they will be absorbed by the government, the government as lender has a better set of incentives in this instance.

And as noted earlier, the idea that the bidding procedures prevented a "market test" of the value of the debtors' assets presupposes that there was a market for these assets.

CONCLUSION

The current reality of chapter 11 is undeniable – it is a sale-driven process, where courts seek to maximize the return to creditors. The Chrysler and GM cases sit contentedly within this arrangement.

In analyzing these cases, it is helpful to consider if a proffered objection would be tenable if a private lender had structured the cases. If not, one has to consider if the special nature of the government, and the powers inherent therein, make a difference or if the critique in question is simply being advanced because of the proponent's discomfort with government involvement in corporate finance.

The objecting creditors in these cases had several options. They could have brought another buyer to the table, they could have credit bid, and they could have even sued the agent banks or indenture trustees that allegedly let them down. The fact that the objecting

[112] A. Mechele Dickerson, *Privatizing Ethics In Corporate Reorganizations,* 93 Minn. L. Rev. 875, 908-09 (2009).

[113] http://www.nytimes.com/2009/06/01/business/01deese.html

creditors did not pursue any of these more traditional options, and instead chose melodrama, is quite telling. Insisting that the buyer pay more than the debtor's assets are worth, or that the buyer pay specific creditors, or that the buyer not pay specific creditors, are not bankruptcy arguments but rather rhetorical arguments.

In short, by and large, I think that the bankruptcy academics' criticism of the automotive bankruptcy cases does not stand up to careful scrutiny. In the future, Congress may choose to consider the policy implications of a chapter 11 process that has become heavily driven by quick asset sales and lender control.[114] But given the reality of current chapter 11 practice, both GM and Chrysler's chapter 11 cases were not all that exceptional.

[114] *See* George W. Kuney, *Let's Make it Official: Adding an Explicit Preplan Sale Process as an Alternative Exit from Bankruptcy*, 40 Hous. L. Rev. 1265, 1267-68 (2004).