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Views from the Bench, 2019

Asset Sales

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2019

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Views from the Bench 2019: Select Issues Involving Asset Sales

Paul M. Basta

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Introduction

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Georgetown University Law Center
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- This panel will address a number of topics relating to asset sales, including limitations on credit bidding, break-up fees, and releases of estate claims against purchasers.
- Our panelists:
  - Hon. Jeffery W. Cavender (U.S. Bankruptcy Court for the Northern District of Georgia)
  - Hon. Sean H. Lane (U.S. Bankruptcy Court for the Southern District of New York)
  - Hon. Karen K. Specie (U.S. Bankruptcy Court for the Northern District of Florida)
  - Paul M. Basta (*Moderator*), Paul, Weiss, Rifkind, Wharton & Garrison LLP
  - Martin J. Bienenstock (*Facilitator*), Proskauer Rose LLP

Overview of Topics

- Credit Bidding
  - Overview, state of play post-*Fisker*
  - Recent case study: *Empire Generating*
- Releases for Purchasers?
  - Recent case study: *Sears*
- Break-up Fees
  - Recent case study: *Energy Future Holdings Corp.*
  - Standards for approval

Panel Topics Addressed in Proskauer's Supplemental Deck:

- Recent case study: *Ditech Holding Corp.*
- Successor liability: the impact of *In re Motors Liquidation Co.*
- Lessons learned from the emergency sale in *Lehman*

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Credit Bidding

Credit Bidding – Overview

- Section 363(k) grants secured creditors the ability to credit bid (*i.e.*, use an offset of any secured claims as consideration instead of cash). *See* 11 U.S.C. § 363(k).
  - A secured creditor may only submit a credit bid in respect of the collateral securing its claims.
  - Generally, a secured creditor may credit bid up to the full face value of its secured claims, notwithstanding the price paid for such claims or other parties' positions regarding the true economic value of the assets to be sold. *See In re SubMicron Sys. Corp.*, 432 F.3d 448, 459 (3d Cir. 2006).
- "The ability to credit-bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price. It enables the creditor to purchase the collateral for what it considers the fair market price … without committing additional cash to protect the loan." *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, n.2 (2012).
  - In *RadLAX*, the Supreme Court held that a secured creditor must be permitted to credit bid its secured claim under a proposed cramdown plan where the debtors seek to sell assets free and clear of its liens; it cannot be compelled to accept the proceeds of a free-and-clear sale without credit bidding protection under the "indubitable equivalent" prong of § 1129(b)(2)(A).
    - The Supreme Court concluded that § 1129(b)(2)(A)(ii), a specific provision that describes the requirements for selling collateral free of liens and preserves the right to credit bid under § 363(k), governs over clause (iii), a generally worded provision that says nothing about such a sale, in the context of a sale pursuant to a cramdown plan.

Credit Bidding – Denial or Limitation for "cause"

- A secured creditor's right to credit bid its debt is not absolute. Section 363(k) of the Bankruptcy Code affords the court discretion to limit or deny a secured creditor's right to credit bid "for cause."
  - Parties may object to a credit bid by raising concerns regarding the allowance of the secured creditor's claim or the validity, priority, or extent of its liens.
  - Courts have found "cause" to deny credit bids where the bidder engages in improper or unfair behavior, such as the failure to comply with court-approved bidding procedures or to disclose the identity of a co-purchaser. *See, e.g., Greenblatt v. Steinberg*, 339 B.R. 458, 463 (N.D. Ill. 2006); *In re Aloha Airlines, Inc.*, 2009 WL 1371950, at *8 (Bankr. D. Haw. May 14, 2009).
- In 2014, the Bankruptcy Court for the District of Delaware and the Bankruptcy Court for the Eastern District of Virginia issued published decisions denying or capping a secured lender's right to credit bid, each of which raised concerns regarding the potential (or ineluctable) chilling effect of the credit bid on competitive bidding. *See In re Fisker Automotive Holdings, Inc.* 510 B.R. 55 (Bankr. D. Del. 2014); *In re Free Lance-Star Publ'g Co.*, 512 B.R. 798 (Bankr. E.D. Va. 2014).

Credit Bidding – Denial or Limitation for "cause" (cont'd)

- The *Fisker* and *Free Lance-Star* decisions garnered attention for underscoring the negative effects of the challenged credit bids on competitive bidding.
- But, as Judge Lane emphasized in *In re: Aéropostale, Inc.*, 555 B.R. 369, 417 (Bankr. S.D.N.Y. 2016), both cases involved other "problematic conduct" that supports a limitation on credit bidding.
  - In *Fisker*, the secured lender "insisted on an unfair [sale] process, i.e., a hurried process, and the validity of its secured status had not been determined." *Id.* (quoting *Fisker*, 510 B.R. at 61).
  - In *Free Lance-Star*, the court found that the creditor "tried to depress the sale price of the Debtors' assets," stressing that the creditor pressured the debtors to "shorten the marketing period for the assets and to conspicuously advertise the creditor's credit bidding rights." *Id.* (citing *Free Lance-Star*, 512 B.R. at 806).
- Having found no inequitable conduct on the secured creditor's part in *Aéropostale*, Judge Lane declined to deny or limit the credit bid on bid-chilling grounds, citing the ABI Commission Report, which notes that "all credit bidding chills an auction process to some extent." *See Aéropostale*, 555 B.R. at 418.

Credit Bidding – Denial or Limitation for "cause" (cont'd) & *Empire Generating* Case Study

- According to Debtwire, between 2016 and 2018 there were contested credit bids in at least 19 large chapter 11 cases.
  - Increasingly, DIP lenders are insisting that proposed post-petition financing orders feature stipulations as to the permissibility of a credit bid.
- ***Discussion topic***: Post-*Fisker,* have courts been any less inclined to deny or limit credit bidding? To what extent do (and should) courts consider the impact of a credit bid on the competitiveness of the sale or auction process?
- **Case Study**: *In re Empire Generating Co, LLC*, Case No. 19-23007 (RDD) (Bankr. S.D.N.Y. 2019)
  - Before filing for chapter 11 protection, the Debtors oversaw negotiations among their primary lenders, Black Diamond, Starwood, and Ares, with an eye towards pursuing a prepackaged plan of reorganization. As time went on, however, it became apparent to the Debtors that Black Diamond and Ares were locked in "an intractable corporate governance dispute."
  - As such, the Debtors opted to negotiate a restructuring support agreement ("RSA") with Black Diamond, its majority lender, pursuant to which the Debtors would pursue a section 363 sale in which Black Diamond would direct the Collateral Agent to credit bid $353 million, the full amount of credit facility claims, for the equity in a stack of three Debtors (including the project/asset-level debtor).

Credit Bidding – *Empire Generating* Case Study (cont'd)

- Structuring the credit bid in that manner required that Black Diamond allow the Debtors to use the cash in their debt service reserve and other collateral accounts to pay all allowed claims against the three reorganizing Debtors in full.
- Notably, testimony at the hearing to approve the bidding procedures estimated the value of the Debtors' primary asset, a power plant, at roughly $250 million (i.e., roughly $100 million less than the value of the credit bid).
- The Debtors stressed that the credit bid "will have the effect of discharging and satisfying the Credit Facility in its entirety, making it unnecessary to solicit votes from Prepetition Lenders or to treat the Credit Facility under the Plans in any way."

➤ Ares and Starwood (the "Minority Lenders") responded in kind, filing a 76-page objection to the RSA and proposed bidding procedures. The Minority Lenders raised the following challenges, among others:

- *Sub Rosa* Plan: The Minority Lenders argued that the credit bid should be denied for "cause" under § 363(k) because it effects a *sub rosa* reorganization that will enable Black Diamond and the Debtors "to circumvent the Bankruptcy Code's procedural safeguards by using an asset sale to deny the Minority Lenders any vote on the reorganization."
  - The Minority Lenders asserted that there was no sound business purpose for the sale, arguing that the Debtors' stated desire to efficiently restructure their indebtedness "is a business justification for *the Chapter 11 process*, not for a contrived asset sale."
  - In that vein, the Minority Lenders asserted that the "whole point of the outsized credit bid is to ***ensure*** there are no cash offers." And inasmuch as the Bid Procedures "are designed to secure a specified outcome instead of maximizing value, they should be denied."

Credit Bidding – *Empire Generating* Case Study (cont'd)

- Violation of Intercreditor Agreement: Acknowledging that the Intercreditor Agreement vests the Collateral Agent with the exclusive authority to submit a credit bid, the Minority Holders maintained that the Collateral Agent's contractual authority to credit bid is "itself limited to the rights of a secured creditor to credit bid in bankruptcy," which "[s]uch rights are specifically limited 'for cause.'" Moreover, the Intercreditor Agreement requires that the Collateral Agent "act for the benefit solely and exclusively of *all* present and future Secured Parties—not just for the benefit of a preferred majority holder."

➤ Following a contested hearing, Judge Robert Drain approved the Debtors' bid procedures motion and RSA assumption motion, overruling the Minority Lenders' objections.

➤ At bottom, Judge Drain emphasized that the Minority Lenders' rights are limited by the provisions of the Intercreditor Agreement, which vests the Collateral Agent with the exclusive right to credit bid.

- The plan effectuating the credit bid does not alter such contractual rights; nor does it feature a "forced third-party release" of the Minority Holders' claims against the Debtors or Black Diamond. As such, the court questioned how the Minority Lenders could be "impaired" pursuant to § 1124. *See* Hrg. Tr. June 4, 2019 (133:12 – 134:21).
- The court further pointed out that if the Debtors had pursued a sale under a plan and the Minority Lenders voted against confirmation, and there was a credit bid, such a plan "would be crammed down under *RadLAX*." Hrg. Tr. June 4, 2019 (126:4-7).
- In response to the argument that Black Diamond's aggressive tactics may be grounds for limiting the credit bid for "cause" under *Fisker*, Judge Drain stressed that hard bargaining is not "cause," and, unlike the unsecured creditors who challenged the credit bid in *Fisker*, here, "[y]our clients bought the debt" and "knew what they were getting into." Hrg. Tr. June 4, 2019 (136:2 – 137:5).

Credit Bidding – *Empire Generating* Case Study (cont'd)

  - As for the Debtors' decision to pursue a transaction with Black Diamond at the umpteenth hour of negotiation, the court found that the record reflected that the Debtors "had to do something" in response to the logjam. Hrg. Tr. June 4, 2019 (137:15-22).
  - In addition, Judge Drain summarily rejected the *sub rosa* or "creeping" plan objections, stressing that the RSA, "which talks about supporting things," is merely a "pathway" to a plan of reorganization. Hrg. Tr. June 4, 2019 (152:15-25).
  - Finally, the court was unmoved by the argument that the pursuit of a comprehensive and efficient in-court restructuring cannot constitute a sound business purpose for the sale, noting that, "[t]here's literally nothing more to ask for" as a business matter after "Black Diamond said 'we'll pay everybody and eliminate the debt.'" Hrg. Tr. June 4, 2019 (150:13-25).

- On June 17, 2019, the Minority Lenders filed notices appealing Judge Drain's orders approving the bidding procedures and the Debtors' assumption of the RSA.
  - ***Discussion topic***: In their motion for leave to appeal, the Minority Lenders assert that the court was "wrong to suggest that the Minority Lenders currently 'lack standing to object to the Credit Bid.'" They maintain that this ruling was "based on the erroneous view that, in allowing the Collateral Agent to credit bid the secured debt, the Credit Agreement also foreclosed the secured creditors from challenging any such credit bid—even one specifically designed to injure specific creditors." Where an Intercreditor agreement expressly vests the Collateral Agent with the exclusive authority to credit bid, are minority lenders precluded from challenging the Collateral Agent's credit bid?
  - ***Discussion topic***: What elements cause section 363 sales to be illegal *sub rosa* plans? Might the doctrine of *sub rosa* plans take on new life after *Jevic*?

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Releases for Purchasers: *Sears*

Releases for Purchasers: *Sears*

- Debtors may agree to release claims against creditors and other third parties in the context of settlement discussions or plan negotiations, in exchange for new value, or otherwise as consideration for a party's contribution to the reorganization of the debtor's estate.
- In assessing whether or not to grant a debtor release, courts consider whether the settlement is fair and equitable and in the best interest of the debtor's estate.
  - Typically, when presented with a proposed release of estate claims under a plan pursuant to § 1129(b)(3)(A) of the Bankruptcy Code, courts will apply the standard applicable to motions made pursuant to Bankruptcy Rule 9019 to determine whether the proposed settlement falls below the lowest point in the range of reasonableness.
- **Case Study**: *In re Sears Holdings Corporation*, Case No. 18-23538 (RDD) (Bankr. S.D.N.Y. 2018)
- Given the number of questionable prepetition insider transactions, including spinoffs, rights offerings, and sales that shifted value to the Debtors' shareholders to the detriment of creditors, the resultant causes of action against ESL Investments, Inc. ("ESL") (i.e., Eddie Lampert's hedge fund) were among the estates' most valuable assets.
- The Restructuring Subcommittee of the Board of Directors of Sears Holdings Corporation, which was comprised of two independent directors (Alan Carr and Bill Transier) appointed in October 2018, was tasked with investigating such claims and authorized to "[p]rosecute, waive, release, settle, negotiate, and bind" Sears Holdings with respect to such claims.

Releases for Purchasers: *Sears* (cont'd)

- The Restructuring Subcommittee was further vested with the power to determine and bind the corporation with respect to the right of and/or extent to which a party that is the subject of its investigation may credit bid pursuant to § 363(k).
- As the Debtors' performance continued to suffer, they were faced with the need to either execute a going-concern sale of their business or liquidate. Confronting a limited number of viable bidders, the Restructuring Subcommittee found itself across the negotiating table from ESL.
- Initially, all of ESL's proposals were conditioned upon a full release of all estate claims against it, including fraudulent transfer actions and breach of duty claims.
- But after multiple rounds of intensive negotiations, the Restructuring Subcommittee accepted an ESL credit bid proposal that featured a release limited to the estates' claims against ESL for disallowance, recharacterization, or subordination of ESL's funded debt claims; all of the estates' other claims against ESL and Lampert, including fraudulent transfer claims, were preserved.
  - That proposal allowed the Debtors to refinance their $350 million junior DIP loan; retain certain contested assets valued at $26 million with the Debtors' estates; remove qualifications on assumption protection agreement liabilities (estimated at $465 million); and cap ESL's right to receive proceeds of litigation recoveries on its § 507(b) and deficiency claims.
  - Judge Drain ultimately approved the credit bid over the objections of the Official Committee of Unsecured Creditors, noting that "the release is, in fact, limited," and concluding that, "Sears gets to reorganize but these claims are preserved, nonetheless. To me, that is a completely fair and reasonable settlement, considering all of the issues, including collection issues." Hrg Tr. Feb. 7, 2019 (237: 15-18; 239: 4-9).

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Break-up Fees

Break-up Fees: Overview

- Break-up fees, or termination fees, are those fees paid to a proposed purchaser (generally a "stalking horse" bidder) by the debtor if the transaction fails to be consummated for certain reasons, including the debtor's acceptance of a higher or better bid.
  - Break-up fees serve to incentivize prospective purchasers to invest the time and resources to diligence the asset and place a bid.
  - Generally, such fees take the form of a specified dollar amount or a percentage of the ultimate transaction value.
  - Break-up fees are subject to enhanced scrutiny *vis a vis* expense reimbursement provisions because break-up fees provide an opportunity for a bidder to profit, sometimes at the expense of the debtor's estate.
- The standard for approval of break-up fees varies by jurisdiction. Some courts apply the business-judgment standard, while others examine whether the fee provides an "actual, necessary" benefit to the estate. Others still look to whether the fee is in the "best interests" of the debtor's estate.

Break-up Fees: *EFH* Case Study

- **Case Study**: *In re Energy Future Holdings Corp.*, 904 F.3d 298 (3rd Cir. 2018).
- Shortly after filing chapter 11 cases, Energy Future Holdings Corp. and Energy Future Intermediate Holding Company LLC began marketing their economic interest in the rate-regulated business of Oncor Electric Delivery Co. LLC, an electricity transmission and distribution system.
- On July 29, 2016, the debtors entered into a merger agreement with NextEra Energy, Inc. under which NextEra would acquire Oncor. The merger agreement included a provision which obligated the debtors to pay NextEra a $275 million termination fee under certain circumstances.
  - The default rule was that the fee would be triggered if NextEra did not acquire Oncor and the debtors either sold Oncor to someone else or otherwise emerged from bankruptcy; however, it was subject to certain exceptions.
    - Notably, the fee obligation would ***not*** be triggered if the agreement was terminated ***by NextEra*** and approval of the merger by the Public Utility Commission of Texas (the "PUCT") was the only outstanding condition to closing.
    - The agreement was silent as to whether the fee would be owed if the PUCT rejected the merger and, as a result of PUCT's rejection, ***the debtors*** terminated the agreement. As such, under those circumstances, the default rule would apply.
- The scope of the debtors' termination fee obligation was the subject of confusion at the hearing to approve the merger agreement.
  - The debtors' financial advisor testified that if the debtors entered into another transaction, even following the PUCT's rejection of the NextEra transaction, the fee would be payable.

Break-up Fees: *EFH* Case Study

  - Counsel for the debtors, however, contradicted the financial advisor's testimony, stating that: "Suffice to say there's no break-up fee if the PUC[T] just denies—outright denies approval. But if the PUC[T] imposes the burdensome condition which is a significant hurdle . . . a break-up fee is triggered."
- In fact, as the Third Circuit later noted, the termination fee obligation did not turn on whether the PUCT outright rejected the merger or imposed a "burdensome condition." Rather, it "hinged on whom it was that took the initiative to terminate the agreement—the Debtors or NextEra." Accordingly, "if the PUCT rejected the merger, the Fee would be payable, so long as it was the Debtors who terminated." 904 F.3d at 304.
- The PUCT subsequently rejected the NextEra transaction. While the merger was "clearly dead," NextEra made it "clear that [it] would appeal the PUCT's decision to all levels of review, leaving the Debtors no choice but to terminate the Merger Agreement and risk triggering the Termination Fee or else incur months or years of continued interest and fee obligations." *Id.* at 306 (citing the bankruptcy court's findings).
- In July 2017, the debtors terminated the agreement and entered into a new merger agreement with another party. A few weeks later, certain creditors of the debtors filed a motion with the bankruptcy court to reconsider its prior approval of the termination fee.

Break-up Fees: *EFH* Case Study

- The bankruptcy court ultimately granted the motion to reconsider, explaining that it had "fundamentally misapprehended the facts as to whether the Termination Fee would be payable if the PUCT failed to approve the NextEra Transaction." *Id.* at 306.
  - The bankruptcy court insisted that no one "focused the Court on a critical fact: the Merger Agreement did not set a date by which approval by the [PUCT] had to be obtained [to avoid automatic termination of the agreement]." *Id.* at 304.
  - And consequently, no party made it aware "that if the PUCT did not approve the NextEra Transaction, the Debtors could eventually be required to terminate the Merger Agreement and trigger the Termination Fee unless NextEra terminated first of its own volition." *Id.*
- The bankruptcy court stated that had it understood the relevant critical facts, it could not, and would not, have approved the termination fee, noting that "under no foreseeable circumstances would NextEra terminate the Merger Agreement . . . [b]ecause NextEra had the ability to hold out . . . until the Debtors were forced by economic circumstances to terminate." *Id.*
- The Third Circuit, in affirming the bankruptcy court's ruling, focused on (i) whether the bankruptcy court misapprehended the facts when it approved the termination fee (as it failed to appreciate that the merger agreement did not include a PUCT approval deadline) and (ii) whether such misapprehension was central to the court's legal calculus in approving the merger agreement.
  - On the first issue, noting that it is bound to accept the bankruptcy court's "factual conclusions regarding its own subjective understanding unless they are clearly erroneous," the Third Circuit found nothing in the record to suggest that the court knew that the agreement lacked a PUCT approval deadline. The Third Circuit stressed that the inquiry is not what the court *should have* known, but rather whether the court actually misapprehended the facts. *See id.* at 312-13.

Break-up Fees: *EFH* Case Study

  - The Third Circuit then considered whether the bankruptcy court's misapprehension of the facts was essential to its legal determination regarding the permissibility of the termination fee under the standard set forth in *In re O'Brien Environmental Energy, Inc.* (*O'Brien*), 181 F.3d 527, 532 (3d Cir. 1999), which provides that termination fees can be approved only if they constitute "actual, necessary costs and expenses of preserving the estate." *Id.* at 535.
    - Under *O'Brien*, bankruptcy courts have discretion to approve or deny a termination fee based on the totality of the circumstances – that is, "to make . . . a judgment call about whether the proposed fee's potential benefits to the estate outweigh any potential harms, such that the fee is 'actually necessary to preserve the value of the estates." *EFH*, 904 F.3d at 314.
  - The Third Circuit held that the bankruptcy court's "error of fact" led the court to "overlook[] a significant potential harm when it initially approved the Termination Fee as drafted by the parties." Specifically, the court "failed to initially recognize that [the] Debtors had essentially gambled on PUCT approval." *Id.*
    - As a result, the bankruptcy court did not correctly weigh the termination fee's potential benefits against its potential harms.
    - Thus, the Third Circuit held that the bankruptcy court did not abuse its discretion by reconsidering its prior approval of the termination fee and denying the fee.
    - In so holding, the Third Circuit stressed that that reconsideration "remains a form of relief generally reserved for extraordinary circumstances," noting that "this case is anomalous." *Id.* at 316.

Break-up Fees: *EFH* Case Study

- ***Discussion topic***: NextEra filed a petition for writ of certiorari (which was ultimately denied) in which it asked the Supreme Court to resolve the Circuit split regarding the standard for approval of break-up fees.
  - Specifically, NextEra presented the following issue: "Whether a debtor's decision to agree to a negotiated breakup fee as part of a sale transaction should be reviewed by the bankruptcy court under the deferential 'business judgment rule' of § 363, as the Fifth Circuit has held, or under the heightened standard of § 503, which requires the bankruptcy court to decide on the debtor's behalf whether the fee is necessary, as the Third Circuit held."

These materials are intended for educational purposes only and not to provide legal advice. No legal or business decision should be based on their content. The information has not been updated since the date of the program.

Views from the Bench 2019: Select Issues Involving Asset Sales

Martin J. Bienenstock

September 20, 2019

Proskauer

Ditech Holding Corp., Case No. 19-10412 (JLG) (Bankr. S.D.N.Y., Aug. 28, 2019)

- Does Bankruptcy Code section 363 govern sales approved at a confirmation hearing? Is section 363 optional?
- Is section 1123(a)(5), (b)(4) a standalone authorization to sell?
- Should the "best interests" test account for distributions from non-debtors?

Successor Liability – Section 363(f) Sales "free and clear"

- Section 363(f) of the Bankruptcy Code authorizes the sale of assets "free and clear" of any "interest" in the property under certain conditions.
- Some courts have construed "interest" narrowly, limiting its scope to security interests, liens, mortgages, and judgments. *See, e.g., In re White Motor Credit Corp.*, 75 B.R. 944, 948 (Bankr. N.D. 1987).
- But the "trend seems to be toward a more expansive reading of 'interests in property' which encompasses other obligations that may flow from ownership of the property." *In re Trans World Airlines, Inc.*, 322 F.3d 283, 289 (3d Cir. 2003).
  - Of note, the Seventh Circuit in *Precision Industries, Inc. v. Qualitech Steel SBQ*, 327 F.3d 537 (7th Cir. 2003) ruled that a lessee's possessory rights constituted an interest in property that could be extinguished in a sale under § 363(f).
  - As for successorship, the Third Circuit stressed that allowing unsecured claims to attach to assets transferred pursuant to a section 363 sale would effectively grant the holders of such claims superior priority and treatment than they would receive in bankruptcy. *See TWA*, 322 F.3d at 289-90.

Successor Liability – Policy & Due Process Considerations: *GM* Case Study

- Complications arise, however, where due process concerns come into play, such as where the debtor's pre-sale activities caused some harm, but the claim is asserted post-sale against the buyer and "the party asserting [the] claim did not bring, and could not have brought, that claim prior to the bankruptcy." *Elliott v. General Motors LLC (In re Motors Liquidation Co.)*, 829 F.3d 135, (2d Cir. 2016).
- **Case Study**: *In re Motors Liquidation Co.*, 829 F.3d 135, (2d Cir. 2016)
- General Motors Corp. ("Old GM") sold substantially all of its assets to General Motors LLC ("New GM") in a section 363 sale in 2009. The bankruptcy court directed Old GM to provide actual notice of the proposed sale order to known creditors of Old GM and publication notice to unknown creditors.
- The sale order provided that the sale would be "free and clear of all liens, claims, encumbrances, and other interests of any kind or nature whatsoever . . . including rights or claims based on any successor or transferee liability," with the exception of certain liabilities that New GM had agreed to assume. *In re General Motors Corp.*, No. 0950026 (Bankr. S.D.N.Y. July 5, 2009) [ECF. No. 2968].
- In 2014, New GM began recalling cars due to an ignition switch defect; many of those cars were built before Old GM's bankruptcy. Class action litigation ensued, and New GM sought to enforce the "free and clear" provision in the GM sale order to enjoin the claims.

Successor Liability – Policy & Due Process Considerations: *GM* Case Study (cont'd)

- Claims being asserted against New GM included:
  - (1) pre-closing accident claims,
  - (2) economic loss claims arising from the ignition switch defect or other defects,
  - (3) independent claims relating only to New GM's conduct, and
  - (4) claims asserted by individuals who had purchased Old GM cars secondhand after the sale closed.

  See 829 F.3d 135 at 150-51.
- The bankruptcy court held that the sale order shielded New GM from "ignition switch claims that otherwise could have been brought against Old GM, unless those claims arose from New GM's own wrongful conduct." *Id.* at 151. It also found that, while some claimants holding such claims had not received adequate notice of the order, they were not prejudiced by the notice deficiency and, thus, were not entitled to relief from the sale order.
- The Second Circuit disagreed with the bankruptcy court regarding both the scope and enforceability of the sale order.
  - The Second Circuit held that a court may approve a § 363 sale 'free and clear' of successor liability claims if: (1) the claims (a) "flow from the debtor's ownership of the sold assets," and (b) arise from a prepetition right to payment or a right to payment that "resulted from prepetition conduct fairly giving rise to such claims," and (2) "some contact or relationship [exists] between the debtor and the claimant such that the claimant is identifiable." *Id.* at 156.

Successor Liability – Policy & Due Process Considerations: *GM* Case Study (cont'd)

  - Accordingly, the Second Circuit concluded that the Sale Order could function to bar "pre-closing accident claims" and "economic loss claims arising from the ignition switch defect or other defects," (the "Covered Claims") but <u>not</u> "independent claims relating only to New GM's conduct" <u>or</u> claims of post-closing used car purchasers. *Id.* at 157-58.
- The Second Circuit then considered whether the Covered Claims plaintiffs were deprived of procedural due process.
  - The court affirmed the bankruptcy court's ruling that Old GM was required to provide holders of Covered Claims with actual notice of the sale order, which it had not done.
    - To determine whether actual notice (rather than publication notice) is required, courts generally consider whether (1) the debtor knew or should have known about the claims, and (2) the identities of potential claimants are known or are easily ascertainable.
  - The Second Circuit agreed with the bankruptcy court that Old GM knew (or should have known) about the ignition switch defect that gave rise to the claims, noting that "federal law requires that automakers keep records of the first owners of their vehicles. . . . Thus, to the extent that Old GM knew of defects in its cars, it would also necessarily know the identity of a significant number of affected owners." 829 F.3d 135 at 159.
  - The Second Circuit found that the claimants <u>were</u> prejudiced by Old GM's failure to provide actual notice.
    - The bankruptcy court held that ignition switch claimants were not prejudiced because "it would have reached the same decision—entered the Sale Order on the same terms—even if plaintiffs had been given an opportunity to be heard." *Id.* at 163.

Successor Liability – Policy & Due Process Considerations: *GM* Case Study (cont'd)

- The Second Circuit disagreed, noting that "the terms of the § 363 sale were not within [the bankruptcy court's] exclusive control. Instead, the GM sale was a negotiated deal with input from multiple parties . . . . The Sale Order and Sale Agreement reflect this polycentric approach: it includes some fifteen sets of liabilities that New GM voluntarily, and without legal compulsion, took on as its own" (including, *e.g.*, its assumption of certain Lemon Law claims raised by numerous state attorneys general). *Id*.
- In that vein, the notice deficiency deprived claimants of the opportunity to participate in the proceedings and to negotiate with New GM regarding the assumption of their claims.

- ***Discussion topic***: Setting aside the fact that Old GM's concealment of the ignition switch claims violated federal law that required the company to disclose defects and recall cars, what type of notice to holders of potential ignition switch claimants would have been adequate to satisfy due process?
  - Would such notice need to effectively inform recipients that they have or may have claims arising out of the defect?
    - In *In re Crumbs Bake Shop, Inc.,* 522 B.R. 766, 776 (Bankr. D.N.J. 2014), the bankruptcy court held that where affected I.P. licensees were merely provided with notice containing copies of a sale motion that failed to "state anything about the treatment of the [licensees] in particular or the effect that the sale would have on their [§ 365(n)] rights" and an APA that "lacked any lucid and specific language that would place the [licensees] on notice that their rights were to be vitiated upon execution of the contemplated sale," it "would be inequitable" to consider the I.P. licensees' failure to object a form of implied "consent" for purposes of satisfying § 363(f)(2).
- ***Discussion topic***: What implications might the *Motors Liquidation Co*. decision have in the section 1141 discharge context?

Emergency Sales: Lessons Learned from *Lehman*

- Lesson 1 - *Only those at the Table Get Fed:* In the Lehman sale Barclays obtained more asset value than liabilities, which enabled it to recognize a multi-billion dollar gain on its acquisition. Lehman employees obtained bonuses for 12 months, notwithstanding that they would work for Barclays for 3 ½ months. All Lehman employees obtained their traditional severance amounts if terminated prior to the end of 3 ½ months. Lehman creditors obtained $250 million which was virtually nothing in comparison to their hundreds of billions of dollars of claims. None of this is surprising given that some Lehman employees who were about to become Barclays employees negotiated the transaction with Barclays. They had no economic incentive to maximize returns for Lehman's creditors, but had incentives to provide their new employer, Barclays, with a great deal.

Emergency Sales: Lessons Learned from *Lehman*

- Lesson 2 – *Colossal Transactions Formulated on the Run without Creditors' Committee Surveillance and Understanding are Destined to Harm the Committee's Constituency:* The harm to creditors commenced when the bankruptcy court denied the statutory creditors' committee's request for an adjournment so it could do diligence. Although speculative, it certainly appears that creditors were injured by $4 billion due to mistakes in the documentation and by billions more due to the inability of the creditors' committee to learn the facts, oppose the transaction, and negotiate. Given that the New York Federal Reserve made an intentional decision on Sunday September 14, 2008 to require Barclays to take over Lehman's $42.7 billion loan before the closing and before bankruptcy court approval, which requirement could not be satisfied due to the need for shareholder approval, it is certainly likely that the consequences of no transaction were not as dire as Lehman claimed, or that the New York Federal Reserve, Barclays, and others would provide additional consideration to Lehman creditors.

Emergency Sales: Lessons Learned from *Lehman*

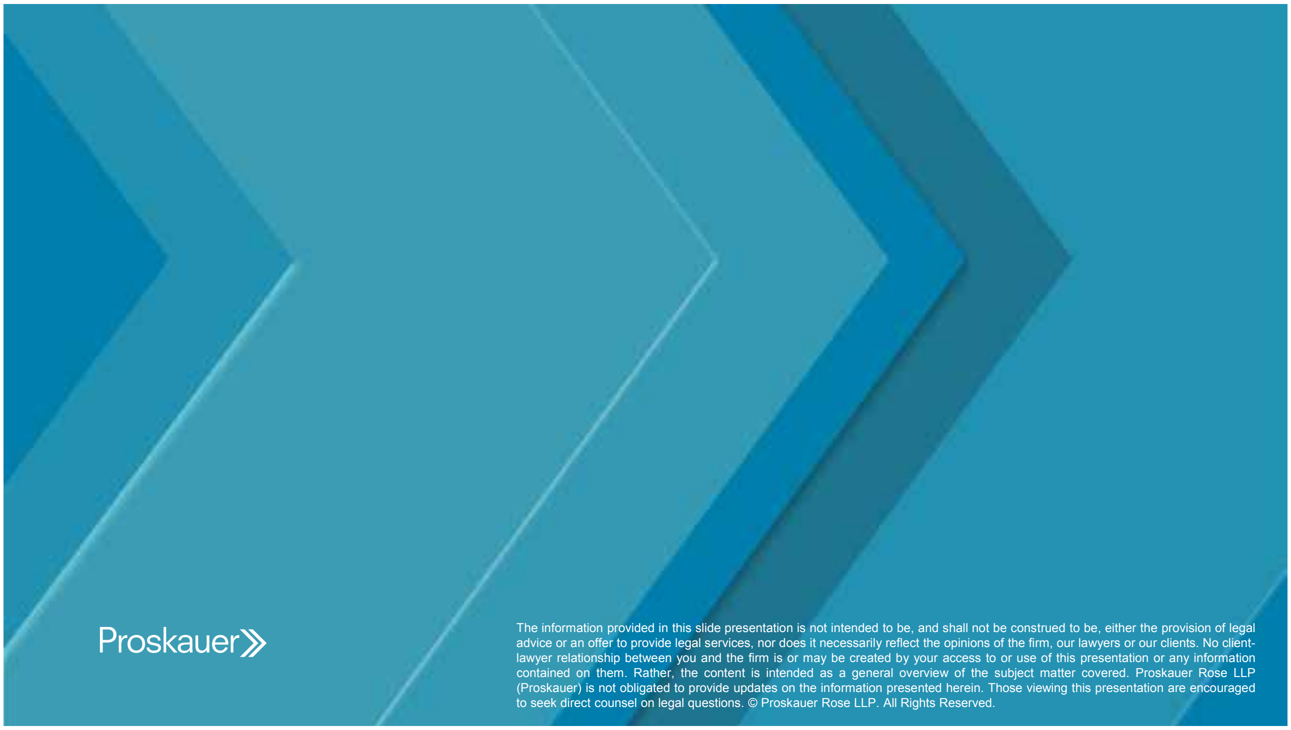
- Lesson 3 – *Attorneys Remain Zealous Advocates for their Clients Notwithstanding Emergency Circumstances*: The attorneys for the purchaser, Barclays, offered no evidence at the sale hearing, such as that approximately 6 days earlier it was considering paying $5 per share or at least $3 billion for Lehman brothers in addition to taking on basically the same liabilities it assumed in the bankruptcy sale. The attorneys for Lehman did not tell the court that (a) its CEO believed Barclays had six days earlier offered $3 billion for what it was now paying $250 million and six days earlier Barclays was willing to purchase Lehman outside bankruptcy with no order protecting Barclays from successor liability and the like, (b) Barclays needed to have a $5 billion buffer of assets above liabilities, (c) Barclays had written down approximately $70 billion of Lehman assets to $47.3 billion, and (d) six days earlier (the day before Lehman's bankruptcy) the New York Federal Reserve had rendered Barclays' takeover of Lehman impossible by demanding that prior to the takeover Barclays must assume Lehman's loan from the Fed, knowing that there was no time for Barclays to obtain the required shareholder approval to do so.

Emergency Sales: Lessons Learned from *Lehman*

- Lesson 4 – *What Caused the Sale Order to Turn Out Inconsistent with the Bankruptcy Court's Intent Concerning $4 Billion of Cash?* The bankruptcy court's decision makes clear it had no intent of approving the transfer of $4 billion of Margin to Barclays, but it signed the order that the district court and Second Circuit ultimately interpreted to do so.

Emergency Sales: Lessons Learned from *Lehman*

- Lesson 5 – *Should the Bankruptcy Court Take into Account Interests Urged by the SIPC, Beyond the Estate's Creditors?* The bankruptcy court did not even know, because it was not told, that the New York Federal Reserve had transferred its claim against Lehman to Barclays. The bankruptcy court speedily approved the sale to Barclays, in part to save the financial system. But, less than one week earlier, the New York Federal Reserve had knowingly stood in the way of Barclays' takeover of Lehman. Accordingly, at the sale hearing, it was not the bankruptcy court's job to save the world. It was the New York Federal Reserve's job, if the world needed saving in the first place. Had the bankruptcy court simply adjourned the hearing Friday night to enable the creditors' committee to do diligence and to let Barclays and the New York Federal Reserve consider giving Lehman a better deal for creditors, the odds appear high creditors would be much better off today. The court could still have approved the sale Saturday night, Sunday, or Monday. At a minimum the rush to judgment was costly because the court's approval misallocated at least $4 billion away from creditors.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Faculty Biographies

Paul M. Basta is a partner with Paul, Weiss, Rifkind, Wharton & Garrison LLP in New York, where he co-chairs its Bankruptcy and Corporate Reorganization Department and is a member of the firm's Management Committee. He represents debtors, creditors and investors in a broad range of restructuring matters, including chapter 11 cases, cross-border insolvency matters, out-of-court restructurings and bankruptcy-related acquisitions. Mr. Basta has represented a diverse range of clients spanning numerous industries in some of the most complex and contentious bankruptcy proceedings in recent years. Some of his significant debtor representations have included advising Sears, Cumulus Media, Barneys, A&P Supermarkets, MoneyGram, LINN Energy, Samson Resources, Sun Healthcare Group, Charter Communications, Global Crossing, Marvel Entertainment, Reader's Digest, Caesars Entertainment Operating Co. Inc., Kerzner International, MS Resorts, TOUSA and Tecumseh Products, among others. He also has experience representing creditors in major bankruptcies and restructuring matters, including funds such as GSO, GoldenTree, Centerbridge, Bain Capital and H Partners. He has also represented numerous private-equity funds in connection with their distressed-portfolio companies. Mr. Basta has been recognized for the past decade as a leading lawyer by *Chambers USA*, earning praise for being an attorney who "is among the 'upper echelons of lawyers," and is regarded as a leading lawyer by *The Legal 500*, *The Best Lawyers in America* and *IFLR1000*. He is a Fellow of the American College of Bankruptcy and a member of the board of directors for Her Justice. He currently teaches a course on corporate restructuring at George Washington University Law School. Mr. Basta received his B.A. in 1988 from the University of Michigan and his J.D. from George Washington School of Law in 1992, where he was a member of the Order of the Coif.

Martin J. Bienenstock is chair of Proskauer's Business Solutions, Governance, Reorganization & Bankruptcy Group in New York. He also teaches governance and reorganization as the Bruce W. Nichols Lecturer in Law at Harvard Law School and the University of Michigan Law School. Currently, Mr. Bienenstock he leads the representation of the Financial Oversight and Management Board for Puerto Rico, and must restructure the territory along with its 63 instrumentalities having \$74 billion of financial debt and \$50 billion of unfunded public pension obligations. He also was retained by General Motors to advise its board and to develop the strategy he presented to the U.S. Auto Task Force and implemented to save Chrysler, Chrysler Financial and General Motors. On the creditors' side, Mr. Bienenstock leads the representations of the Westinghouse and Caesars Entertainment creditors' committees. He was retained by the creditors in Owens Corning when their positions were valued at \$600 million, and he won a landmark appellate court ruling providing those clients with a \$2.25 billion recovery. He also charted the takeover of troubled Finova for a joint venture between Berkshire Hathaway and Leucadia National Corp., and achieved the successful reorganizations of companies such as Enron and Republic Engineered Products over multiple objections, as well as developed successful reorganizations for Capmark and AMBAC. In addition, he prepared the initial draft of what became Ireland's reorganization statute. Mr. Bienenstock helps corporations modify their governance to increase share value, protect officers and directors, and be prepared for shareholder activists. For the last 10 years, the *National Law Journal* ranked him as one of the "100 Most Influential Lawyers in America." Mr. Bienenstock received his B.S. in 1974 from the University of Pennsylvania, Wharton School of Business and his J.D. from the University of Michigan Law School.

Hon. Jeffery W. Cavender is a U.S. Bankruptcy Judge for the Northern District of Georgia in Atlanta, sworn in on March 2, 2018. Prior to his appointment to the bench, he was a partner in the financial restructuring practice of Troutman Sanders LLP, where he primarily represented corporate debtors and secured lenders in chapter 11 cases and mortgage servicers in consumer-related litigation and bankruptcy matters. Judge Cavender previously was a partner in the bankruptcy group of McKenna Long & Aldridge LLP (n/k/a Dentons LLP) and served as the general counsel for a national mortgage company. He chaired the Bankruptcy Section for the Atlanta Bar Association from 2017-18 and was a member of its board of directors from 2012-18. During Judge Cavender's tenure as chair, the Atlanta Bar Bankruptcy Section was named the national CARE chapter of the year and received the Pro Bono Award for Excellence and the Small Section of the Year Award from the Atlanta Bar. He is an active member of ABI, having previously served on the advisory committee for its Southeast Bankruptcy Workshop. He currently chairs the New Members Committee for the National Conference of Bankruptcy Judges. Judge Cavender received his undergraduate degree in history *summa cum laude* in 1990 from Berry College, and his J.D. *cum laude* from the University of Georgia School of Law in 1993, where he was a member of the *Georgia Law Review* and was inducted into the Order of the Coif.

Hon. Melanie L. Cyganowski chairs Otterbourg P.C.'s Bankruptcy practice in New York. She joined the firm in 2008 after serving a full 14-year term as a U.S. Bankruptcy Judge for the Eastern District of New York and as its Chief Judge from 2005-08. She currently represents the State of Texas in connection with opioid bankruptcy issues, and her fiduciary appointments include receiver in *SEC v. Platinum Partners*, an alleged billion-dollar fraud; CRO and temporary operator of Brooklyn's Interfaith Medical Center, a 287-bed acute-care teaching hospital; patient care ombudsman in *Promise Healthcare*, *Orianna Health Systems*, *21st Century Oncology* and *California Proton*; auditor of Capital One; and various trusteeships. She has also served as a special master in *Vivendi* and *Neogenix Oncology*, a court-appointed expert in *Orion HealthCorp*, and an arbitrator/mediator in numerous cases including *Madoff* and *Lehman Brothers*. In addition, she has testified as an expert in international cases involving U.S. bankruptcy laws. Prior to taking the bench, Ms. Cyganowski clerked for the late Hon. Charles L. Brieant, former Chief Judge in the Southern District of New York, then was a litigator at Sullivan & Cromwell and Milbank, Tweed, Hadley & McCloy. In addition, she mediated a dispute involving 19 state attorneys general and the chapter 7 trustee in *ITT* involving the issue of retention of student records. Ms. Cyganowski is a Fellow of the American College of Bankruptcy and a member of the American and New York State Bar Foundations. In addition, she sits on the editorial advisory board of the *Norton Journal of Bankruptcy Practice & Law*, and is an adjunct professor of law at St. John's University School of Law. Ms. Cyganowski received her J.D. *magna cum laude* from the State University of New York at Buffalo School of Law in 1981.

Hon. Sean H. Lane is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Sept. 7, 2010. He clerked for Hon. Edmund V. Ludwig, U.S. District Judge for the Eastern District of Pennsylvania, from 1991-92, as well as for Hon. Charles R. Richey, U.S. District Judge for the District of Columbia, from 1992-93. From 1993-97, he practiced with the law firm of BakerHostetler in Washington, D.C., and thereafter served as a trial attorney in the Department of Justice, Civil Division, National Courts Section, until 2000. From 2000 until he was appointed to the bench, Judge Lane served as an assistant U.S. attorney for the Southern District of New York and was also chief of the Tax & Bankruptcy Unit of that office. During his time in the U.S. Attorney's Office, he was awarded the Attorney General's Distinguished Service Award in 2005 and the Henry L. Stimson Medal by the New York City Bar Association in 2008. Judge Lane is a member of the Federal Bar Council and has served as an adjunct professor at both New York University School of Law and Fordham Law School. He received his B.A. from New York University College of Art & Science in 1987 and his J.D. from New York University School of Law in 1991.

Hon. Karen K. Specie is the Chief U.S. Bankruptcy Judge for the Northern District of Florida in Tallahassee, also presiding over cases in Gainesville, Panama City and Pensacola. She began her legal career with a Manhattan law firm, representing creditors in commercial litigation and bankruptcy. She then practiced with Fowler, White, Boggs, *et al.* in Tampa and has practiced solo and as a shareholder with firms in Gainesville; just prior to taking the bench, Judge Specie was Of Counsel to Akerman LLP as part of its Bankruptcy and Reorganization practice group in Jacksonville, Fla. While in private practice,she focused on commercial litigation and commercial and consumer bankruptcy cases throughout Florida and the Southeast. Judge Specie has taught bankruptcy and secured transactions as an adjunct professor of law at the University of Florida Levin College of Law, where she still teaches advanced bankruptcy. She has served as a chapter 7 panel trustee for the Northern District of Florida, is a founder of the Federal Bar Association for North Central Florida, and has been a member of the Bankruptcy/UCC Committee of the Business Law Section of The Florida Bar since the early 1990s. Judge Specie currently serves on the Executive Council of the Florida Bar Business Law Section, is a Fellow of the American College of Bankruptcy, and is a member of ABI, INSOL, IWIRC and NCBJ. In 2018, she chaired the committee that organized and presented the Bankruptcy Roundtable at the Eleventh Circuit Judicial Conference. In addition to traveling throughout the Northern District to perform her judicial duties, Judge Specie routinely speaks at CLE programs for various organizations such as The Florida Bar, the Alabama Bar Association, the Jacksonville Bankruptcy Bar Association and the Northern District of Florida Bankruptcy Bar Association. She received her B.A. from the University of South Florida and her J.D. from Florida State University College of Law.