Interpreting the Supreme Court’s Treatment of the Chrysler Bankruptcy and its Impact on Future Business Reorganizations

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Abstract

On June 9, 2009, the Supreme Court terminated its stay of Chrysler’s sale of substantially all of the company’s assets to a new entity, dubbed “New Chrysler” with the backing of European automaker Fiat. The effect of that ruling was to permit the sale to close the next day and bring to an end a chaotic period that determined Chrysler’s future. However, critics of the sale to Fiat argued that the Supreme Court’s ruling would also have a detrimental effect on secured credit and undermined the creditor protections normally afforded by Chapter 11 going forward.

But the Supreme Court was not finished with the Chrysler case. In December 2009, the Court issued a brief and somewhat cryptic ruling vacating the Second Circuit’s opinion upholding the bankruptcy court’s approval of the sale and ordering the Court of Appeals to dismiss the dissenting secured creditor’s appeal as moot.

What did the Court’s December decision mean? What are its ramifications going forward? And why did the court wait six months to issue its decision instead of addressing the case before Chrysler’s sale took effect? These are the questions this paper will answer. Ultimately, I conclude that the Court’s December decision was an expression of its disagreement with the Second Circuit’s interpretation of the requirements of §363(b), the section of the Bankruptcy Code that permits debtors to sell assets outside of the ordinary course of business, and that the effect of the decision is to prevent the Second Circuit’s opinion from having any value as a controlling precedent in future bankruptcies. Determining why the Court waited until six months after the Chrysler sale (as well as General Motors restructuring) is a more difficult question.

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Introduction

On June 9, 2009, the Supreme Court terminated its stay of Chrysler’s sale of substantially all of the company’s assets to a new entity, dubbed “New Chrysler” with the backing of European automaker Fiat. The effect of that ruling was to permit the sale to close the next day and bring to an end a chaotic period that determined Chrysler’s future. However, critics of the sale to Fiat argued that the Supreme Court’s ruling would also have a detrimental effect on secured credit and undermined the creditor protections normally afforded by Chapter 11 going forward. According to those critics, the structure of the sale that the Supreme Court had allowed to go forward—and which both the Bankruptcy Court for the Southern District of New York and the Second Circuit had expressly approved as permissible—permitted debtors to subvert the absolute priority rule of §1129 and threatened to swallow the entirety of Chapter 11. The Supreme Court’s refusal to halt the sale served as a tacit endorsement of the legality of this sale structure.

But the Supreme Court was not finished with the Chrysler case. In December 2009, the Court issued a brief and somewhat cryptic ruling vacating the Second Circuit’s opinion upholding the bankruptcy court’s approval of the sale and ordering the Court of Appeals to dismiss the dissenting secured creditor’s appeal as moot.

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This paper is divided into four parts. In Part I, I discuss the chain of events that led to Chrysler’s sale and the Supreme Court’s December decision. In Part II, I discuss that decision and its possible interpretations. In Part III, I offer possible explanations for why the Court waited until the dust had settled in the automakers’ restructurings before announcing its decision. And in Part IV, I discuss the effect of the Court’s December decision on bankruptcy law and business reorganizations going forward.

I. Background to the Supreme Court’s Decision: Financial Trouble, Restructuring Efforts and Bankruptcy Proceedings

A. Chrysler’s Road to Bankruptcy

The struggles of the U.S. auto industry came to a head in early 2009 amidst a global recession and resulting tightening of credit. Two of the three largest American automakers, General Motors and Chrysler, found themselves unable to obtain financing from private lenders and were only able to continue operating in late 2008 and early 2009.

Though the Second Circuit’s ruling will likely continue to have some precedential value, particularly in Bankruptcy Courts in the Second Circuit. see infra Part IV.B.
thanks to an infusion of billions of dollars from the U.S. government. For Chrysler, that funding came in the form of a $4.0 billion loan from the Treasury as part of the Troubled Asset Relief Program (“TARP”) announced December 20, 2008. Conditions to that loan required Chrysler to submit a detailed restructuring plan to the Treasury, renegotiate its contracts with employee labor unions and reduce its debt load. Less than a month later, on January 16, 2009, the Treasury announced it was loaning an additional $1.5 billion to Chrysler’s financial services subsidiary, Chrysler Financial.

Throughout this entire period, Chrysler—and its majority owner, Cerberus Capital Management, L.P.—were seeking another company interested in acquiring Chrysler. In the fall of 2008, G.M. expressed interest in such an acquisition but was unable to obtain the necessary financing. By January 2009, Italian automaker Fiat, S.p.A had emerged as the leading candidate for an acquisition. Fiat and Chrysler tentatively agreed to form an alliance. Under the agreement, which was subject to approval by the U.S. Treasury, Fiat would receive a 35% equity interest in Chrysler and access to its dealership network. In return, Chrysler would receive access to Fiat technology—specifically regarding fuel-

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10 *In re Chrysler LLC*, et al., 405 B.R. 84, 96 (Bankr. S.D.N.Y. 2009) (noting Chrysler’s efforts in preceding two years to find an alliance).

efficiency of vehicles—and Fiat’s distribution network outside of the U.S. However, Chrysler’s debt load, totaling over $15 billion, posed a substantial barrier to any effort to make the company viable.

On February 17, Chrysler submitted its restructuring plan, which included the proposed alliance with Fiat, to the Treasury to be reviewed by Treasury Secretary Timothy Geitner and President Obama’s Auto Task Force. On March 30, the White House announced it had determined Chrysler’s restructuring plan was not viable and ordered the company to submit an alternative plan to restructure the company within 30 days or face a cutoff of any future financing from the U.S. government. The Administration’s assessment of Chrysler’s restructuring plan stated that an alliance with Fiat could be a part of a viable plan but concluded that Chrysler had not taken sufficient steps to renegotiate its labor contracts or reduce its debt burden to ensure the company’s long-term viability. The Administration also suggested that bankruptcy might provide the best opportunity for the automaker to ensure its future viability.

Throughout April, both the company and the Treasury Department attempted to arrange an acquisition of Chrysler by another company and to negotiate an agreement among Chrysler’s 46 secured creditors to reduce the amount of Chrysler’s debt in order to

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\textbf{B. Chrysler’s Capital Structure}

At the time of Chrysler’s bankruptcy filing, the company’s equity was privately held; Cerberus and its affiliates held 80.1\% of the company’s shares and Daimler AG and its affiliates the remaining 19.9\%.\footnote{In re Chrysler, LLC, 405 B.R. at 89.} Chrysler had also incurred a vast amount of debt, which had contributed to the company’s struggles: $6.9 billion in senior debt secured by substantially all of Chrysler’s assets; $2 billion in second lien secured debt owed to affiliates of Daimler and Cerberus; $4 billion in TARP loans owed to the U.S. Treasury and secured by a lien on unencumbered assets and a junior lien on all encumbered assets; and approximately $5.34 billion in debt owed to trade creditors.\footnote{Id. at 89-90.}

\textbf{C. Chrysler’s Restructuring Plan}

Under its agreement with Fiat, Chrysler would file for bankruptcy under Chapter 11 and then sell nearly all of its assets to a newly created shell corporation, “New Chrysler”, in exchange for consideration from the shell corporation consisting of $2 billion in cash as well as assumption of certain liabilities including all obligations to

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  \item $6.9 billion in senior debt secured by substantially all of Chrysler’s assets;
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  \item approximately $5.34 billion in debt owed to trade creditors.
\end{itemize}

current and retired Chrysler employees and $500 million owed to the U.S. government of
the original $4 billion TARP loan.\textsuperscript{21} Fiat would obtain a 20% equity interest in the new
corporation—an interest that could increase up to 35% if certain performance targets
were met.\textsuperscript{22} A trust established to provide retirement benefits to former Chrysler
employees ("Retirees’ Trust") would receive a 55% equity interest in New Chrysler as
consideration for a separately negotiated collective bargaining agreement with the United
Auto Workers ("UAW").\textsuperscript{23} The agreement also called for New Chrysler to give $1.5
billion in cash and a $4.6 billion unsecured note to the UAW Trust.\textsuperscript{24} The U.S. Treasury
would take an 8% interest and the Canadian government an additional 2% equity interest
in return for commitments from those governments to loan New Chrysler $6.2 billion that
would be used to purchase Chrysler’s assets.\textsuperscript{25}

The $2 billion Chrysler received for the sale of its assets would become part of its
bankruptcy estate and ultimately be distributed to its secured lenders under a
reorganization plan as satisfaction of those creditors’ claims against the company. As a
result, these lenders would receive less than 29 cents on the dollar for their $6.9 billion in
pre-petition claims.\textsuperscript{26} Chrysler’s shareholders would receive nothing for either their
equity positions or their second-priority debt. Likewise, all other creditors—aside from
those whose liabilities New Chrysler assumed as consideration for Chrysler’s assets—
would receive nothing for their claims. The plan provided that the U.S. Treasury would

\begin{itemize}
  \item \textsuperscript{21} Press Release, Fiat S.p.A., Master Transaction Agreement dated as of April 30, 2009 among Fiat S.p.A.,
  New CarCo Acquisition LLC, and Chrysler (Apr. 30, 2009), (on file with author).
  \item \textsuperscript{22} \textit{Id.}
  \item \textsuperscript{23} \textit{In re Chrysler, LLC}, 405 B.R. at 92.
  \item \textsuperscript{24} \textit{Id.}
  \item \textsuperscript{25} Press Release, U.S. Department of the Treasury, Obama Administration Auto Restructuring Initiative
  Chrysler-Fiat Alliance (Apr. 30, 2009), \textit{available at} http://www.ustreas.gov/press/releases/tg115.htm; \textit{In re
  Chrysler, LLC}, 405 B.R. at 92, 100.
  \item \textsuperscript{26} Press Release, U.S. Department of the Treasury, \textit{supra} note 25.
\end{itemize}
serve as Chrysler’s debtor in possession lender and provide up to $4.5 billion of financing to permit the company to continue operating as its bankruptcy proceeded.

**D. Chrysler’s Bankruptcy Proceedings**

The day after filing its petition, May 1, Chrysler filed a motion to sell substantially all of its assets to New Chrysler free and clear of the secured creditor’s security interests, arguing that section §363 of the Bankruptcy Code\(^\text{27}\) permitted the company to so do. On May 19, a group of secured creditors (the Indiana State Teachers Retirement Fund, Indiana State Police Pension Trust, and Indiana Major Move Construction; collectively the “Indiana funds”) that together held approximately $42 million of Chrysler’s $6.9 billion in secured debt filed an objection to Chrysler’s motion to sell assets. The Indiana funds argued that the sale violated the Absolute Priority Rule of §1129(b) of the Code by giving value to junior claimholders—including the U.S. government, the Retirees’ Trust, the UAW and unsecured trade creditors—while not paying the senior secured creditors’ claims in full. Specifically, the Indiana funds argued the assets’ value as a going concern was worth more to New Chrysler than the amount the secured creditors received in the sale and that part of this additional value would be transferred to these junior claimholders in the transaction.\(^\text{28}\)

1. **The Bankruptcy Court’s Opinion**

After a three-day hearing, on May 31, Bankruptcy Judge Arthur Gonzalez released his decision granting Chrysler’s motion and permitting the company to sell its assets to New Chrysler.\(^\text{29}\) The opinion ruled that the sale was permitted by §363 and was


\(^{28}\) *In re Chrysler LLC*, 405 B.R. at 93.

\(^{29}\) *Id.* at 84.
not a \textit{sub rosa} reorganization plan.\textsuperscript{30} The court relied on the Second Circuit’s interpretations of §363 in \textit{In re Lionel}\textsuperscript{31} and \textit{In re Iridium Operating, LLC}\textsuperscript{32} to hold that a court may approve a §363 sale when the debtor shows first, “a proper business justification” and second, that the sale is not designed “to evade the plan consent process.”\textsuperscript{33} In the case before it, the court held the proposed sale would preserve at least part of Chrysler’s value as a going concern as well as maximizing the value available to Chrysler’s creditors, both “proper business justifications”.\textsuperscript{34} The court based its holdings, in part, on the fact that Chrysler had ceased operating. The court stated that delaying the sale—and thus the resumption of operations—“would result in substantial costs”\textsuperscript{35} and reduce the value of both the assets and Chrysler’s bankruptcy estate.\textsuperscript{36} In addition, the court noted that despite “highly publicized and extensive efforts” by Chrysler to find a buyer, the Fiat transaction was the company’s only alternative to liquidation. In light of uncontroverted testimony from Chrysler’s valuation expert that suggested a liquidation of Chrysler’s assets would yield at most $800 million,\textsuperscript{37} the court held Chrysler was justified in preferring the sale to liquidation.\textsuperscript{38} The court also found that conducting the sale so early in the bankruptcy process—rather than searching for another buyer in the hope of obtaining a higher purchase—was justified in light of Fiat’s right to walk away from the

\textsuperscript{30} \textit{Id.} at 87.
\textsuperscript{31} Comm. of Equity Sec. Holders v. Lionel Corp. (\textit{In re Lionel Corp.}), 722 F.2d 1063 (2d Cir. 1983).
\textsuperscript{32} Motorola v. Comm of Unsecured Creditors (\textit{In re Iridium}), 478 F.3d 452 (2d Cir. 2007).
\textsuperscript{33} \textit{In re Chrysler LLC}, 405 B.R. at 95-96 (citing \textit{In re Iridium}, 478 F.3d at 466).
\textsuperscript{34} Id. at 96.
\textsuperscript{35} “[I]ncluding the amounts required to restart the operations, loss of skilled workers... suppliers and dealers who could be forced to go out of business in the interim, and the erosion of consumer confidence.” \textit{Id.}
\textsuperscript{36} \textit{Id.}
\textsuperscript{37} Testimony which the Indiana funds objected to because the expert was to receive a $17 million transaction fee upon the closing of a sale of Chrysler’s assets. \textit{In re Chrysler LLC}, 405 B.R. at 96 n.17.
\textsuperscript{38} \textit{In re Chrysler LLC}, 405 B.R. at 97.
sale if not closed by June 15 and the U.S. Treasury’s threat to not fund the transaction if the sale did not close quickly.\textsuperscript{39}

The court also dismissed the claims by the Indiana funds that the sale amounted to a \textit{sub rosa} reorganization plan. The court concluded the $2.0 billion New Chrysler was paying for the assets was a fair value, noting that “the true test of value is the sale process itself” and no other buyer had stepped forward offering a higher price.\textsuperscript{40} The court reasoned that since the sales’ proceeds would go entirely to the debtor and ultimately the senior secured creditors, the sale was not a \textit{sub rosa} plan.\textsuperscript{41}

In response to the creditors’ allegations that the sale transferred value to junior claimholders, the court ruled that the distribution of cash, notes and equity positions in New Chrysler to the Retirees’ Trust, the UAW, trade creditors and the U.S. and Canadian governments were permissible under the Bankruptcy Code. The court explained that §365(a) and (f) of the Code permitted Chrysler to assume and then assign to New Chrysler any executory contract, including contracts between Chrysler and any of its unsecured trade creditors. Furthermore, §365(b) permitted payments and adequate assurances of future payments to those creditors whose contracts the debtor assumed. Thus, the court held, any distributions on behalf of an assumed contract did not violate the absolute priority rule or constitute a \textit{sub rosa} plan.\textsuperscript{42} The court also ruled the distributions New Chrysler was required to make to those parties under the “master transaction agreement” would be made on account of contributions of new value those parties promised to make in “separately-negotiated agreements with New Chrysler”,

\textsuperscript{39} \textit{Id.} at 96-97.
\textsuperscript{40} \textit{Id.} at 98.
\textsuperscript{41} \textit{Id.} at 97.
\textsuperscript{42} \textit{Id.} at 99.
rather than on account of the parties’ prepetition claims: the U.S. Treasury would provide the financing necessary to effect the transaction and the UAW would provide New Chrysler with a skilled workforce under a newly negotiated collective bargaining agreement that included a six-year no-strike clause.\textsuperscript{43} The court ruled New Chrysler’s payments to the Retirees’ Trust were permissible because New Chrysler’s commitment to make those payments were part of its modified collective bargaining agreement with the UAW and in light of evidence the UAW would not have agreed to a collective bargaining agreement without such distributions.\textsuperscript{44} Thus, the court concluded the proposed sale of Chrysler’s assets was not a \textit{sub rosa} plan and was permitted under §363(b) of the Code.

The Indiana funds further argued that because they did not consent to the sale, it did not meet the requirements of §363(f) for a sale free and clear of any interest of a party other than the debtor and therefore the Indiana funds should retain their security interest in the assets after the sale to New Chrysler. However, the court concluded the sale complied with §363(f) because the secured creditors’ “Collateral Trustee” had consented to a free and clear sale. As part of the credit agreement with Chrysler, the Indiana funds, along with the rest of the secured creditors, had entered into ancillary agreements which provided that in the event Chrysler defaulted under the agreement—which it did by filing its bankruptcy petition—the Collateral Trustee had the exclusive right to pursue the secured creditors’ rights in the collateral.\textsuperscript{45} The court ruled that under the loan documents the Indiana funds were bound by the Trustee’s consent and could not object to a “free-and-clear” sale. Therefore, under §363(f)(2), the Indiana funds’ liens against the assets

\textsuperscript{43} \textit{Id.} at 99-100.
\textsuperscript{44} \textit{Id.} at 100-01.
\textsuperscript{45} \textit{Id.} at 101-02.
would terminate upon the sale to New Chrysler. For these reasons, the court overruled the Indiana funds’ objection and granted Chrysler’s motion to go forward with the sale of its assets free and clear of any and all liens.

2. The Second Circuit’s Opinion

The Indiana funds quickly appealed the bankruptcy court’s opinion to the Second Circuit, which granted a motion to stay the sale, and for an expedited appeal. On June 5, the court heard oral arguments and made a bench ruling affirming the bankruptcy court’s order granting Chrysler’s motion to sell its assets. In the Second Circuit’s written opinion, which was released in August, after the sale had closed, the court discussed the history and justifications for §363’s provisions as well as the threats §363 sales posed to the goals Chapter 11 was intended to accomplish.

The court stated that the Bankruptcy Act’s predecessor to §363 was based on a “melting ice cube theory” which advocated permitting the debtor to sell assets “of a perishable nature or liable to deteriorate in value”. The court argued that while traditionally the section had been cited to justify sales of truly “perishable” assets like fruits and vegetables, the “melting ice cube theory” could be applied to justify asset sales in any situation in which present circumstances rendered those assets’ value certain to decrease in the near future. The court cited Lionel as supporting the proposition that under §363(b) the sale should be permitted so long as Chrysler had a “good business reason” for the sale, and agreed with the bankruptcy court’s findings that Chrysler had sufficient justifications for the sale—specifically, to maximize the value of the

46 Id. at 102.
47 Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC), 576 F.3d 108 (2d Cir. 2009).
48 Id. at 127.
49 Id. at 113 (citing In re Lionel, 722 F.2d at 1066).
50 Id. at 113-14 (citing In re Lionel, 722 F.2d at 1069).
bankruptcy estate. The court based its conclusion on the debtor’s valuation expert’s testimony that the $2 billion proposed purchase price was greater than the assets’ liquidation value. The court also felt postponing the sale to search for higher bids would likely result in a smaller recovery for the estate for two reasons: (1) the failure of any bidders aside from Fiat to emerge during Chrysler’s public search for a suitor and (2) Chrysler’s decreasing going concern value as the company’s plants sat idle and its cash reserves continued to be depleted by its obligations to pay rents and salaries. The Second Circuit also agreed with the bankruptcy court’s rulings that the sale did not amount to a sub rosa plan—for reasons that I will discuss in further detail in Part III.B.3 of this paper—and that the Indiana funds were bound by the Collateral Trustee’s consent to the sale free and clear of the secured creditors’ liens on the assets being sold.

The Second Circuit also addressed the Indiana funds’ argument regarding the legality of the Treasury Department using TARP funding to finance the acquisition. The Emergency Economic Stabilization Act (“EESA”) granted the Treasury Department the authority “to... fund commitments to purchase troubled assets from any financial institution.” The Act defined “financial institution” to include “any bank, savings association, credit union, security broker or dealer, or insurance company.” The funds argued that Chrysler was an automaker, not a financial institution, and thus, the Treasury, by financing the Chrysler sale, had exceeded its authority under the EESA. In response, the government argued that under the EESA “any industry so ‘inter-related’ with banks

51 Id. at 117-19 (citing In re Lionel, 722 F.2d at 1071).
52 Id. at 118.
53 Id. at 119.
54 Id. at 118-19.
57 In re Chrysler LLC, 576 F.3d at 121-22.
that its dealings could adversely impact the national banking system is, for TARP purposes, a financial institution.\textsuperscript{58} While the court did not endorse the government’s expansive interpretation of “financial institution”, it refused to uphold the funds’ appeal citing a lack of standing.\textsuperscript{59} The court ruled the funds had not suffered an “injury in fact” because they were receiving “fair value” in return for the release of their collateral and thus had no standing to challenge Treasury’s financing of the sale.\textsuperscript{60} For these reasons, the court denied the Indiana funds’ appeal and affirmed the bankruptcy court’s sale order.

3. Justice Ginsburg Orders Temporary Stay, Supreme Court Vacates

After failing to prevail at the Second Circuit, the Indiana funds appealed to the Supreme Court seeking a stay of the sale. On June 8, Justice Ginsburg ordered the sale be temporarily stayed until the full Court could review the case.\textsuperscript{61} However, the very next day, the Supreme Court, in a \textit{per curiam} opinion, denied the Indiana funds’ request for a stay and vacated the temporary stay.\textsuperscript{62} In its brief opinion, the Court explicitly stated that it offered no opinion on the merits of the funds’ appeal. Instead, the Court simply ruled that while a stay was “an exercise of judicial discretion”, the Indiana funds had not established that “the circumstances justify an exercise of that discretion”.\textsuperscript{63} According to the Court, in order to establish that a stay was appropriate, the Indiana funds needed to show “(1) a reasonable probability that four Justices will consider the issue sufficiently meritorious to grant certiorari...; (2) a fair prospect that a majority of the Court will

\textsuperscript{58} Id. at 122.
\textsuperscript{59} Id. at 122-23.
\textsuperscript{60} Id.
\textsuperscript{63} Id.
conclude that the decision below was erroneous; and (3) a likelihood that irreparable harm will result from the denial of the stay." While the Court denied the request for a stay, it did not explain which of these three factors the Indiana funds had failed to show. Thus, with all legal obstacles out of the way, the sale of Chrysler’s assets to New Chrysler closed on June 10.

II. The Supreme Court’s December 14, 2009 Opinion

On December 14, over six months after the Supreme Court terminated Justice Ginsburg’s stay and permitted Chrysler’s sale of its assets to New Chrysler to close, a unanimous Court issued a short, cryptic decision addressing the Indiana funds’ appeal:


Without discussing its reasons for doing so, the Court vacated the Second Circuit and bankruptcy court opinions granting Chrysler’s motion to sell its assets an did so prior to a full briefing and oral argument by the parties on the appeal’s merits. The decision voiced no opinion on the Second Circuit’s interpretation of §363(b), the validity of the Collateral Trustee’s consent, or the Indiana funds’ standing to challenge the Treasury’s use of TARP funds to finance the sale. However, the Indiana funds’ appeal still ultimately failed as the Court ordered the Second Circuit to dismiss the appeal for mootness.

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64 Id. (quoting Conkright v. Fommert, 129 S. Ct. 1861 (U.S. Apr. 30, 2009)).
The Second Circuit followed the Supreme Court’s instructions precisely and in a decision released January 25, 2010, held that its prior decision was vacated and dismissed the Indiana funds’ appeal as moot without any further explanation.66

So what effect did the Supreme Court’s decision actually have? The sale of Chrysler’s assets to New Chrysler was not unwound and the reorganized company continues to operate. The New Chrysler-Fiat transaction was carried through as planned with Fiat, the Retirees’ Trust and the U.S. and Canadian governments receiving their promised equity positions in New Chrysler. The secured creditors, including the Indiana funds were paid a total of only $2 billion for their $6.9 billion in secured claims against Chrysler. None of these results are any different than what would have transpired if the Supreme Court had simply denied the Indiana funds’ petition for a writ of certiorari.

Given the low number of petitions granted each year, a simple denial of the funds’ petition would not have been unusual even if the Court did not agree with the Second Circuit’s opinion. However, the fact the Court even bothered to address the case for a second time makes it highly unlikely that the Court’s decision is totally superfluous. So, the Supreme Court’s ruling must have some effect. In the following sections, I will discuss the various theories as to what motivated the Court’s December 2009 decision and attempt to determine exactly what the decision means going forward.

III. Possible Explanations of the Court’s Opinion

There are a number of plausible interpretations of the Supreme Court’s decision and it is possible that the nine justices had different motivations in agreeing to sign on to the opinion. Two such interpretations are discussed below. An important issue on which these interpretations disagree is whether the Supreme Court’s decision prevents the

66 Ind. State Police Pension Trust v. Chrysler LLC, 592 F.3d 370 (2d Cir. 2010).
Second Circuit’s opinion from having any precedential effect going forward. Part IV discusses the decision’s effect on future §363 cases.

A. Dismissing Indiana Funds’ Appeal for Mootness

One possible explanation for the Supreme Court’s opinion in Chrysler is that the Court was simply dismissing the Indiana funds’ appeal of the Second Circuit and bankruptcy court opinions because the appeal had become moot due to the closing of the sale of Chrysler’s assets to New Chrysler in June. Solicitor General Elena Kagan argued just as much in her brief in opposition to the Indiana funds’ petition for a writ of certiorari. Kagan argued that §363(m) of the Code precluded “reversal or modification” of the sale by the Court. §363(m) states,

> The reversal or modification on appeal of an authorization under subsection (b)... of this section of a sale... of property does not affect the validity of a sale... under such authorization to an entity that purchased... such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale... w[as] stayed pending appeal.

Since the sale had already closed, any further judicial review was thus limited to whether New Chrysler was a “good faith purchaser”—a question the bankruptcy court and Second Circuit had already answered in the affirmative and which the Indiana funds did not dispute. A determination as to the legality of the “distribution of proceeds” from the sale and any redistribution of said proceeds would be a “reversal or modification” of the sale barred by §363(m). Thus, the Indiana funds’ appeal of the sale order was moot.

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70 Brief for the Solicitor General in Opposition, supra note 67 at 11.
If this alone is the proper interpretation of the Court’s decision, then the Court’s opinion should not be read as passing disapproval upon the Second Circuit’s opinion.\textsuperscript{71} As a result, the court of appeals’ opinion would still have precedential value going forward. This seems to be the interpretation adopted by counsel for Chrysler. Todd Geremia, a partner at Jones Day, who represented Chrysler during the appeals process, stated when asked about the decision, “Nothing in this [opinion] reflects any disagreement with the Second Circuit. It’s an order that arises from the application of Munsingwear.”\textsuperscript{72}

However, this explanation still does not account for why the Court chose to grant certiorari in the first case. During the Supreme Court’s term that concluded in 2009, the Court received 8,241 petitions for a writ of certiorari and granted only about 1% of those petitions.\textsuperscript{73} Thus, while it is possible that the Court really did grant certiorari and issue its December opinion solely in order to effectively voice no opinion on the merits of the appeal or the Second Circuit’s opinion and maintain the status quo, it seems unlikely given that the Court could have accomplished the same result by simply denying the Indiana funds’ petition for certiorari. The argument that the Court was simply dismissing the Indiana funds’ appeal for mootness falls short as it fails to explain why the Court would grant certiorari and issue an opinion if it desired to just maintain the status quo.

\textbf{B. Rejecting the Second Circuit’s Holding}


At a minimum, then, it would seem the Court’s opinion and decision to vacate was aimed at diminishing the precedential value of the Second Circuit’s opinion by refusing to endorse that court’s conclusions on the issues the Indiana funds’ appeal presented. In fact, the Solicitor General, in a prior case, made essentially this same argument:

Mootness during the pendency of a certiorari petition does not provide a basis for vacatur if the case would not otherwise have warranted review by this Court. If the Court would have denied certiorari in any event, there is no unfairness in leaving the lower court’s decision intact. As a general rule, where the judgment would not otherwise have been reviewed by this Court, vacatur would disserve the public interest by eliminating a judicial precedent that our judicial system regards as “presumptively correct,” see U.S. Bancorp Mortgage, 513 U.S. at 26, ... Accordingly, the long-standing position of the United States has been that, when a case becomes moot while a petition for certiorari is pending, the petition should be denied if the case would not have warranted review on the merits. See, e.g., U.S. Br. in Opp. at 5–8, Velsicol Chemical Corp. v. United States, 435 U.S. 942 (1978) (No. 77-900). Although this Court has never expressly endorsed that standard, the Court has denied certiorari in a number of such cases (including Velsicol itself) and has thus decidedly not adopted a policy of automatically vacating the lower court decision whenever a case has become moot while a certiorari petition was pending. To the contrary, the Court “has seemingly accepted the suggestion of the Solicitor General that it need not consider the often difficult question of mootness at the certiorari stage when a case is otherwise not worthy of review. In such cases the Court will merely deny certiorari.” Robert Stern et al., Supreme Court Practice 724 & n.29 (7th ed. 1993) (footnote omitted).

The negative implication of this argument, then, is that the Supreme Court will only order vacatur of a case that has become moot before reaching the court when it “believes that some or all of the discretionary factors ordinarily governing its certiorari decision point toward a grant”75 and wishes to prevent a lower court’s decision from being perceived as “presumptively correct” and serving as a precedent in future cases.

75 Ralph Brubaker & Charles Jordan Tabb, supra note 71 at 31-32 (citing ROBERT L. STERN ET AL., SUPREME COURT PRACTICE § 19.4, (9th ed. 2007)).
Thus, it seems a more likely explanation for the Supreme Court’s ruling is that the Court disagreed with the Second Circuit’s opinion and wanted to ensure the court of appeals’ opinion would not have precedential value going forward. Thomas Lauria, a partner at White & Case LLP who represented the Indiana funds, stated that such was his explanation for the Court’s decision, “In granting our petition for certiorari and going on to give us the extraordinary relief of striking in its entirety the Second Circuit’s ruling (without even requiring the filing of briefs on the merits or hearing argument), the court validated our position that serious error had occurred.” 76

However, as the Second Circuit’s opinion addressed multiple objections that the Indiana funds raised to the sale, such an interpretation does not explain what about the Second Circuit’s ruling the Court disagreed with. If this is the correct explanation for the Court’s ruling, the Court may have disagreed with the Second Circuit’s interpretation of §363(b), its ruling regarding the Indiana funds’ standing to challenge the Treasury’s use of TARP funds to finance the sale, or both. 77 Below, I analyze the merits of the Second Circuit’s ruling as to each argument the Indiana funds’ appeal raised in order to determine the likelihood that the Court’s ruling was an expression of its disagreement with the Second Circuit’s treatment of each issue. Professor Warburton has suggested yet another ground on which the Supreme Court may have been voicing its disagreement with the Second Circuit. His argument is also discussed below.

1. Indiana Funds’ Lack of Standing to Challenge Treasury’s Use of TARP Funds to Finance Chrysler’s Asset Sale

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76 Pete Brush, supra note 72.
77 The Indiana funds did not appeal the Second Circuit’s ruling finding consent under §363(f) had occurred due to the trustee’s grant of consent. Petition for Certiorari, supra note 69.
One possible explanation of the Court’s ruling was it was intended to disagree with the Second Circuit’s ruling that the Indiana funds lacked standing to challenge the Treasury’s use of TARP funds to finance New Chrysler’s purchase of Chrysler’s assets. However, this explanation is unlikely as even if the Court disagreed with the Second Circuit’s conclusion that New Chrysler paid “fair value” in the asset sale, the funds still lacked standing due to a lack of a connection between Treasury’s conduct and any harm suffered by the funds.

For a party to have standing to sue, it must satisfy the three prongs of the standing doctrine: (1) “the plaintiff must have suffered an injury in fact”, (2) “there must be a causal connection between the injury and the conduct complained of”, and (3) “it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.” 78 I address each of these prongs in turn.

The Supreme Court defines “injury in fact” as “an invasion of a legally protected interest which is (a) concrete and particularized... and (b) actual or imminent, not conjectural or hypothetical.” 79 The Second Circuit concluded that the funds had not suffered an injury in fact since the price paid for Chrysler’s assets was “fair” and thus the funds lacked standing. 80

As discussed below, because of difficulties in valuing businesses, it is basically impossible to know for certain if the $2 billion purchase price was fair. 81 However, if the price were less than the going concern value of Chrysler’s assets, the amounts the secured creditors would receive on behalf of their claims against Chrysler would be less than

78 Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-61 (citations omitted).
79 Id. at 560 (citations omitted).
80 In re Chrysler LLC, 576 F.3d at 123.
81 infra section III.B.3.c.2.
what they would receive if the sale had been made for a fair price. Thus, at least arguably, the Indiana funds had suffered an injury in fact.

However, regardless of whether the “injury in fact” question was decided correctly, the link between the funds’ harm and the conduct complained of—Treasury’s use of TARP funds to finance the asset purchase—almost certainly was not the sort of causal relationship required under the standing doctrine. For a causal relationship to exist, the Supreme Court requires “the injury... be fairly... trace[able] to the challenged action of the defendant, and not... the result [of] the independent action of some third party not before the court.”

In Chrysler, the injury the Indiana funds complained of was receiving less from the sale of Chrysler’s assets than the funds felt they were entitled to. However, this alleged injury was not caused by Treasury’s conduct in providing financing to the assets’ buyer, but rather by the buyer’s low bid and Chrysler’s decision to accept the bid. In fact, in light of the state of the credit markets in spring of 2009, had the Treasury not been willing to finance the purchase, it is likely Chrysler would have been unable to find a buyer with the ability and desire to buy its assets and the automaker would have been forced to instead liquidate. According to the testimony of Chrysler’s valuation experts, such a sale would have resulted in a much smaller recovery for the secured creditors. For these same reasons, the Indiana funds also likely failed the third prong of the standing doctrine: the likeliness that a favorable decision would redress the party’s injury. If a judge had forbid the Treasury from financing the sale, Chrysler likely would have been forced to liquidate.

Thus, the Second Circuit’s conclusion that the Indiana funds lacked standing to challenge the Treasury’s use of TARP funds to finance the purchase of Chrysler’s assets

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82 Lujan, 504 U.S. at 560 (citations omitted).
was almost certainly correct and it is unlikely the Supreme Court’s December opinion was motivated by a disagreement with the court of appeals’ decision on this issue.

2. Overextension of §363(m)’s Mootness Doctrine

In a recent article, Professor A. Warburton suggests “the Supreme Court’s order may have been intended to signal that the Second Circuit had over-extended the mootness doctrine” of §363(m) of the Code. According to Warburton, the Court’s decision may have been a rejection of the Second Circuit’s prior holdings that §363(m) prevented an appeal from considering the allocation of the proceeds of a consummated §363 sale or any other aspect of the sale aside from whether the party acquiring the debtor’s assets had done so in good faith.

Professor Warburton’s suggestion seems an unlikely explanation of the Court’s decision for at least three reasons. First, if the Supreme Court had intended to signal that the Second Circuit had overextended the mootness doctrine found in §363(m), it would have been well served to explicitly state thus in its opinion. Nothing in the Court’s brief opinion would indicate to the Second Circuit that it had been misinterpreting §363(m) and should, in the future, interpret that subsection in a different manner. Second, the Supreme Court ordered the Second Circuit to dismiss the appeal as moot—an ironic if not peculiar resolution if the Court really felt the Second Circuit had been too willing to dismiss appeals for mootness. If the Supreme Court felt that §363(m) did not extend to disagreements over the allocation of the proceeds of a §363 sale, it likely would have

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84 *Id.* at 37.
85 *Id.* at 36-7.
86 However, given the Court’s silence on its reasoning, the same counterargument could be made in regard to any interpretation of the Court’s decision.
instead remanded the case to the Second Circuit with instructions to hold further hearings in order to determine whether the allocation was permissible. Third, the Second Circuit’s opinion did not once reference §363(m) or whether the appeal was moot, likely because at the time the Second Circuit issued its order, the sale had not closed and was subject to a stay. Thus, §363(m) had not yet taken hold so as to render any appeal of the sale order moot. Vacating the Second Circuit’s judgment, then, in no way affected the existing precedent regarding §363(m) or signaled an opinion on how that section should be interpreted, as the judgment it vacated offered no such opinions.

3. Misapplication of §363(b) and its Requirements

So if the Court’s December ruling was intended to express disagreement with a part of the Second Circuit’s opinion, that part was most likely the Second Circuit’s application of §363(b) of the Bankruptcy Code to the Chrysler case. To determine whether the Second Circuit’s analysis of §363(b) was erroneous, one must first understand the subsection and its requirements.

a. §363(b) and its Requirements

§363(b)(1), provides,

“The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate...”

While the text of the statute seems to permit any sale outside of the ordinary course so long as notice is given to interested parties, courts applying the statute have interpreted the provision as including additional requirements before a sale may be approved under §363(b). Chief among these is the business purpose test, which the Second Circuit espoused in In re Lionel.

In considering what the proper standard would be for determining the permissibility of a proposed sale under §363(b), the Lionel court noted the need for a standard that would fulfill one of the Bankruptcy Code’s intended purposes: “to counteract the natural tendency of a debtor in distress to pacify large creditors with whom the debtor would expect to do business, at the expense of small and scattered public investors.” The court concluded the business purpose test would accomplish that end by allowing a court to approve a sale of assets under §363(b) only when the debtor can show “some articulated business justification, other than appeasement of major creditors, for... selling... property out of the ordinary course of business.” The Lionel court provided a non-exclusive list of factors for courts to take into consideration when determining if there is a good business reason for a §363(b) sale:

“the proportionate value of the asset to the estate as a whole, the amount of elapsed time since the filing, the likelihood that a plan of reorganization will be proposed and confirmed in the near future, the effect of the proposed disposition on future plans of reorganization, the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property, which of the alternatives of use, sale or lease the proposal envisions and, most importantly perhaps, whether the asset is increasing or decreasing in value.”

Examples of business justifications held to satisfy the requirement include avoiding the administrative costs associated with converting a Chapter 11 case to Chapter 7, permitting a transaction that will maximize the value of the debtor’s estate to close when

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90 Id. at 1070.
91 Id. at 1071.
time is of the essence,\footnote{In re Oneida Lake Dev., Inc., 114 B.R. 352 (Bankr. N.D.N.Y. 1990).} and preserving the debtor’s going concern value.\footnote{Elizabeth B. Rose, Comment, Chocolate, Flowers, and 363(b): The Opportunity for Sweetheart Deals Without Chapter 11 Protections, 23 EMORY BANKR. DEV. J. 249, 269-270 (2006); e.g. In re Naron & Wagner, Chartered, 88 B.R. 85 (Bankr. D. Md. 1988).} Courts have also held §363(b) requires any proposed sale be made for a “fair and reasonable price”.\footnote{In re Industrial Valley Refrigeration and Air Conditioning Supplies, Inc., 77 B.R. 15, 21 (Bankr. E.D. Pa. 1987); In re Abbotts Dairies, 788 F.2d 143, 149-50 (3d Cir. 1986).}

The final requirement is that a court may not approve a sale of assets under §363(b) that amounts to a “\textit{sub rosa} reorganization plan”, a prohibition announced by the Fifth Circuit in \textit{In re Braniff} and which courts in other circuits have subsequently adopted in some form. The \textit{Braniff} court explained that the requirement’s purpose was to prevent §363 sales from “short circuit[ing] the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan \textit{sub rosa}.”\footnote{Pension Benefit Guaranty Corporation v. Braniff Airways, Inc. (\textit{In re Braniff}), 700 F.2d 935, 940 (5\textsuperscript{th} Cir. 1983).} While courts have struggled with finding a precise definition of what exactly constitutes a \textit{sub rosa} plan,\footnote{In re Chrysler LLC, 576 F.3d at 117.} the description the \textit{Braniff} court gave is insightful. The court broadly defined \textit{sub rosa} plans as a sale of assets under §363(b) that “would change the composition of the debtor's assets and have the practical effect of dictating the terms of a future reorganization plan.”\footnote{In re Leo A. Jasik, 727 F.2d 1379, 1383 (5\textsuperscript{th} Cir. 1984) (citing \textit{In re Braniff} at 940).}

The expressed purpose for the prohibition—to prevent a sale from “short circuiting” Chapter 11’s requirements for the confirmation of a plan—offers additional insight, as do the facts of \textit{Braniff} and the structure of the proposed sale.

The transaction the court in \textit{Braniff} concluded was a \textit{sub rosa} plan involved the sale of substantially all of Braniff Airways’ assets to Pacific Southwest Airlines (“PSA”) in return for travel scrip with a face value of $7.5 million as well as other consideration. The travel scrip paid to Braniff in connection with the sale could be redeemed for travel
on PSA flights. However, the sale agreement between the two airlines imposed limitations on who could use the scrip and for what purposes. The agreement “required that the scrip be used only in a future Braniff reorganization and that it be issued only to former Braniff employees or shareholders or, in a limited amount, to unsecured creditors.” These terms, the court declared, “had the practical effect of dictating some of the terms of [the] reorganization plan” since “the reorganization plan would have to allocate the scrip according to the terms of the... agreement or forfeit a valuable asset.”

The Braniff court also objected to provisions in the sale agreement conditioning the sale on secured creditors agreeing to vote in favor of the sale and on all parties to the reorganization agreeing to release any claims against the debtor, its officers and directors and its secured creditors. The court argued that such provisions were not a “use, s[ale] or lease” as contemplated by §363(b) and thus outside of the court’s authority under that section of the Code to approve. Thus, out of Braniff, a definition of sub rosa plans emerged that focused on whether a proposed §363(b) sale had the effect of ensuring a reallocation of the value of a debtor’s estate amongst claimholders in some manner other than that provided by Chapter 11 of the Bankruptcy Code.

However, the Second Circuit has adopted a significantly different method to identify sub rosa plans than that espoused by the Fifth Circuit in Braniff and adopted by other courts. In the Second Circuit, the courts define as sub rosa plans only sales for which there is no legitimate business purpose. This test, as applied, effectively

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99 In re Braniff at 939.
100 Id. at 940.
101 Id. at 940.
102 In re Iridium, 478 F.3d at 466 (“In this Circuit, the sale of an asset of the estate under § 363(b) is permissible if the ‘judge determining [the] § 363(b) application expressly find[s] from the evidence presented before [him or her] at the hearing [that there is] a good business reason to grant such an application.’”) (citing In re Lionel, 722 F.2d at 1071).
conflates the prohibition on *sub rosa* plans and the business justification requirement espoused by *Lionel*. As I discuss below, the effect of this rule is to greatly reduce the creditor protections otherwise available under Chapter 11.

While courts have interpreted §363(b) as imposing certain limitations on what pre-plan sales of assets are permitted, courts have agreed that the section does not impose limits on the quantity of the debtor’s assets being sold. Instead, courts have routinely held that §363(b) permits the pre-plan sale of substantially all of a debtor’s assets, so long as §363(b)’s requirements are satisfied. Thus, the Chrysler sale was not impermissible under §363(b) solely because of the proportion of the Chrysler’s assets being sold.

b. Second Circuit’s Application of §363(b)

As discussed earlier, after applying the *Lionel* test, the Second Circuit ruled that the sale of Chrysler’s assets to New Chrysler satisfied the requirements of §363(b). The court concluded the debtor had proposed the sale with a legitimate business justification in mind—namely, to maximize the value of the debtor’s estate—and thus satisfied *Lionel*’s “good business reason” requirement.

Turning to the issue of whether the sale was a *sub rosa* plan, the court first engaged in an analysis of the history and motivation for the prohibition against such sales. The court looked to *Braniff* and concluded “a §363(b) sale may well be a

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104 *In re Chrysler*, 576 F.3d, 118-19.
reorganization in effect without being the kind of plan rejected in Braniff.”105 The court cited Lionel as standing for the proposition that the Code allows some tradeoffs between §363 and the creditor protections in Chapter 11 when necessary to “increase (or maintain) the value of an asset to the estate, by means of a... sale of... assets.”106 At the same time, the court conceded that under Lionel, §363(b) [does not] grant[] the bankruptcy judge carte blanche” to approve pre-plan asset sales and that the proper standard for determining when a court should prohibit a §363(b) sale as a sub rosa plan must balance “the competing concerns of efficiency [(maximizing the value of the debtor’s estate)] against the safeguards of the Chapter 11 process.”107 Ultimately, the court concluded the proper standard for balancing these concerns and determining whether a §363(b) sale was an impermissible sub rosa plan was whether the sale served a legitimate business purpose, thus conflating the sub rosa prohibition with Lionel’s legitimate business objective requirement.108 Applying this test, the court concluded the sale was not a sub rosa plan.

However, while the test the court declared turned solely on the existence of a good business reason, the Chrysler court’s analysis of the sub rosa issue did go a bit further than just a repetition of the business objective test and—in four sentences—the court briefly addressed the Indiana funds’ argument that the sale was a sub rosa plan because it violated Chapter 11’s priority rules by redistributing the value of the debtor’s

105 Id. at 117 (citing Fla. Dep’t of Revenue v. Piccadilly Cafeterias, Inc., 128 S. Ct. 2326, 2330 n.2 (2008)) (emphasis added).
106 Id. at 114. (citing In re Lionel, 722 F.2d at 1069).
107 Id. at 114.
108 Id. at 117. (citing In re Iridium, 478 F.3d at 466) (“Although Lionel did not involve a contention that the proposed sale was a sub rosa or de facto reorganization, a bankruptcy court confronted with that allegation may approve or disapprove a §363(b) transfer that is a sale of all or substantially all of a debtor's assets, using the analysis set forth in Lionel in order to determine whether there was a good business reason for the sale.”).
estate to junior claimholders without paying senior creditors’ claims in full. The court agreed with the bankruptcy court’s analysis of the issue and rejected the funds’ argument. The court concluded that all value being paid to other creditors in connection with the Chrysler-Fiat transaction, including the equity stakes in the new entity, “were entirely attributable to new value--including governmental loans, new technology, and new management.”\footnote{Id. at 118 (citing In re Chrysler LLC, 405 B.R. at 94).} Thus, the court upheld the bankruptcy court’s decision finding that the sale of Chrysler’s assets to New Chrysler was not a sub rosa plan.

c. Analyzing the Second Circuit’s Decision

Was the Second Circuit’s decision in Chrysler correct? Does a sale that is “a reorganization in effect” not trigger the prohibition against sub rosa plans? Is Lionel’s business purpose test the proper vehicle for determining whether a sale is a sub rosa plan? A comparison of the disputed Chrysler sale with that challenged in Braniff helps shed light on the strength of the Second Circuit’s reasoning.

1) Chrysler v. Braniff

In Braniff, as discussed above, the sale agreement mandated that the reorganization plan allocate portions of the sale proceeds to certain parties and only for certain purposes or the debtor would forfeit those proceeds. The sale agreement only involved two parties: the debtor and the purchaser. None of the debtor’s creditors were parties to the agreement.\footnote{In re Braniff, 700 F.2d at 940.} Also, the sale agreement did not include any agreements with the debtor’s employees. Rather, the buyer separately sent letters to the debtor’s

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\footnote{Id. at 118 (citing In re Chrysler LLC, 405 B.R. at 94).}
\footnote{In re Braniff, 700 F.2d at 940.}
employees inviting them to apply for positions with the buyer that would be effectively the same as their job with the debtor.\textsuperscript{111}

So, the effect of the proposed sale in \textit{Braniff} would have been that the debtor received the consideration from the buyer in return for substantially all of its assets. After the sale, the debtor would have no remaining business and would distribute the consideration from its asset sale to its creditors. Because of the terms of the sale agreement, some of the consideration (the travel scrip) would have to be paid to junior claimholders in order to avoid forfeiting that portion of the sale proceeds. None of the debtor’s claimholders would receive any consideration in connection with the asset sale, aside from those amounts received in distributions by the debtor made according to a court-approved reorganization plan. After the sale, the buyer would be free to hire any or none of the debtor’s former employees. Likewise, the buyer would be free to negotiate separate agreements with any of the debtor’s other creditors.

Compare the situation in \textit{Braniff} with the Chrysler sale. In \textit{Chrysler}, the “master transaction agreement” purported to be between only the buyer (New Chrysler), Fiat (as the sole member of the buyer) and the debtor.\textsuperscript{112} However, the agreement also included several provisions that had the effect of incorporating agreements between those parties and parties who held claims against Chrysler’s bankruptcy estate into the master transaction agreement or conditioning the agreement upon the buyer entering contractual relationships with “old” Chrysler claimholders. For example, the agreement included a representation and warranty by the buyer that rendered the allocation of equity stakes in the buyer to junior creditors of Chrysler (the Retirees’ Trust and the U.S. and Canadian


governments) a condition to the sale.\footnote{113} The agreement also obligated the buyer to “make an offer of employment to each [Chrysler] employee” for the same pay and in the same location as each employee received while employed by Chrysler.\footnote{114} The agreement also conditioned the sale on the buyer reaching a “settlement agreement” with the UAW to provide retirement benefits to former employees of the debtor.\footnote{115}

So, the effect of the sale in Chrysler was that the debtor received some consideration from the buyer in return for substantially all of its assets. In addition to receiving Chrysler’s assets in return for making cash payments to the debtor, the buyer (the shell company “New Chrysler”), under the master transaction agreement, was also obligated to make distributions of equity stakes, debt instruments and cash to one unrelated party (Fiat), two junior secured creditors (the U.S. and Canadian governments) and a group of unsecured creditors (the UAW and retired employees). As in \textit{Braniff}, after the sale, the debtor had no remaining business and distributed the consideration it received from the buyer to its creditors. In Chrysler’s case, the cash consideration received was all to be distributed to the company’s senior secured creditors. As discussed above, some of the debtor’s claimholders received additional consideration in connection with the asset sale, aside from those amounts distributed by the debtor as part of a court-approved reorganization plan. As part of the sale, the buyer was required to offer employment to all of the debtor’s former employees and under similar terms as formerly offered by “Old Chrysler”. Likewise, the buyer was obligated to negotiate and reach separate agreements with some of the debtor’s other creditors.

\footnotetext{113}{\textit{Id.} at Section 4A.06, 8.01(a).} \footnotetext{114}{\textit{Id.} at Section 6.01.} \footnotetext{115}{\textit{Id.} at Section 8.01(m).}
This analysis of the Braniff and Chrysler sales reveals primarily a difference in the forms of the disputed transactions while the sales’ effects on the post-bankruptcy positions of favored junior claimholders are fairly similar. While the Braniff sale paid all the consideration from the sale to the debtor and dictated how the debtor was to distribute the consideration under the debtor’s reorganization plan, the Chrysler sale avoided the need to dictate any plan terms while affecting the same result by providing distributions be made to Chrysler creditors directly rather than the debtor. The post-bankruptcy positions of favored creditors in both cases (former employees in Braniff and the UAW Trust and the government entities in Chrysler), however, are similar: both receive some consideration that originated from the buyer of the debtor’s assets (and, at least arguably, were given on account of claims against the bankruptcy estate and represented a distribution of the value of the debtor’s estate). But, in Chrysler, the court focused on one trait of the Braniff sale which was lacking in the Chrysler sale: the Braniff sale attempted to dictate the terms of the debtor’s future reorganization plan and the Chrysler sale did not. The Second Circuit is mistaken in limiting the holding in Braniff to sales that explicitly dictate the terms of a debtor’s plan rather than any sale which affects the respective positions of all interested parties after the reorganization.

116 In many ways, the terms of the Chrysler sale go further to establishing the terms of the debtor’s reorganization than the suspect terms in Braniff. While any future payments or relationships between PSA and Braniff’s debtors would arise out of agreements negotiated separately from and subsequent to the sale of Braniff’s assets, the agreement in Chrysler expressly contemplates, and in some cases conditions the sale upon, relationships and distributions from New Chrysler to Old Chrysler creditors. For example, while the Chrysler sale is conditioned upon the buyer offering employment to each Chrysler employee, the Braniff agreement provided for no future relationship between Braniff employees and PSA. Instead, PSA planned to separately contact and negotiate with Braniff employees. The value of the travel scrip, the distribution of which the court concluded rendered the Braniff sale a sub rosa plan was $7.5 million. In contrast, in connection with the reorganization of Chrysler, New Chrysler distributed $1.5 billion in cash and $4.6 billion in notes in addition to a majority of the equity stake in New Chrysler to creditors of Old Chrysler. In Chrysler’s sale, Old Chrysler’s creditors would receive distributions from the buyer immediately upon the sale’s closing. In contrast, in Braniff’s case, no claimholders would receive distributions of the travel scrip until a reorganization plan had been developed and approved.
2) Critiquing the Second Circuit’s Application of the Sub Rosa Plan Prohibition in Chrysler

The different outcomes reached in Braniff and Chrysler despite the two transactions’ similar effects are best explained by the different tests employed by the Fifth and Second Circuits, respectively, in those cases to determine whether the sale was a sub rosa plan. While the Braniff court’s analysis was seemingly separate form the question of whether the debtor had a legitimate business reason justifying the sale, the Chrysler court combined the two questions into effectively a single inquiry. This application of the sub rosa prohibition by the Second Circuit has two primary weaknesses which can lead to inequitable outcomes. First, it ignores the fact that valuations of a business’s assets or going concern value are inherently uncertain (especially as conducted in the bankruptcy context). Second, it ignores the distributional consequences of §363(b) sales, thereby allowing those claimholders with greatest leverage over the debtor to harness the uncertainty surrounding business valuations to secure for themselves a greater portion of the debtor’s going concern value than they would otherwise be entitled to under the provisions of Chapter 11, a result both the Lionel court and Congress claimed the Bankruptcy Code was intended to avoid. As a result, the Second Circuit’s rule allows §363(b) sales to operate as a loophole to the protections otherwise afforded to claimholders by Chapter 11.

The Second Circuit’s version of the sub rosa prohibition still provides creditors with some protections, though they will be much more limited than those provided by

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118 In re Lionel, 722 F.2d at 1070 (quoting S. Rep. No. 95-989 at 10, 95th Cong. 2d Sess. 9 (1978)).
119 see Jason Brege, Note, An Efficiency Model of Section 363(b) Sales, 92 VA. L. REV. 1639, 1640 (2006).
Chapter 11. For instance, even under the Second Circuit’s test, a sale will not be approved when the total consideration to be paid to the debtor is less than the estimated liquidation value of the debtor’s assets, since, in such a scenario, it is unlikely the debtor could establish a good business reason for agreeing to the sale rather than liquidating. However, even this protection is limited by the uncertainty inherent in business valuations and the control debtors exercise over the valuation process. Another protection the Second Circuit’s version of the sub rosa plan prohibition affords creditors is their ability to credit bid when they feel a sale price is unfairly low. However, such an option will only offer any protection to larger creditors with claims for an amount larger than or relatively equal to the buyer’s bid. A credit bid will also only be an option for a creditor with the desire and ability to use or sell the assets.

However, the Second Circuit’s application of the sub rosa prohibition greatly undermines many of the protections Chapter 11 affords creditors, chief among them the “absolute priority rule” embodied in §1129(b)(2)(B)(ii) of the Code. The protections in Chapter 11, both substantive and procedural, were designed, in part, to ensure distributions of the debtor’s value were made in a fair and equitable manner. Thus, §1129(b), for example, provides that if a claim holder does not “receive or retain on account of such claim property of a value... equal to the allowed amount of such claim... the holder of any claim or interest that is junior... will not receive or retain... on account

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120 See Ralph Brubaker & Charles Jordan Tabb, supra note 71 at 21-22 (suggesting creditor’s ability to credit bid offers protection against unfair §363(b) sales).
121 Credit bidding will not offer much protection to smaller creditors as they will still be required to provide cash to the extent their bid exceeds the value of their claim against the debtor.
122 Arguably, creditors are at a disadvantage to outside bidders in their ability to maximize the value of the debtor’s assets. Potential buyers are likely to be other industry participants with expertise in utilizing the debtor’s assets. In contrast, creditors, especially large secured creditors able to make credit bids, are typically financial institutions with limited expertise in the debtor’s industry.
of such junior claim... any property.”

Similarly, §1129(a)(7) provides that a plan may only be confirmed if each claimholder “has accepted the plan; or will receive... under the plan... property of a value... not less than the amount such holder would receive if the debtor were liquidated under chapter 7.”

Yet, despite Chapter 11’s explicit concern with how a debtor’s value is distributed among claimholders, the Second Circuit’s §363(b) analysis pays little attention to the distributional effects of a proposed pre-plan sale of assets.

The Second Circuit’s mistake is in its misplaced reliance on Lionel’s business objective test to uphold the creditor protections afforded and priorities created by Chapter 11. While Lionel’s test is a good tool to ensure a proposed §363(b) sale does not diminish the value of the debtor’s estate, it fails to account for the other protections in Chapter 11 due to the test’s inability to account for the limitations of business valuations and the form a §363(b) sale takes. One of the factors Lionel relies on to establish a business justification for a sale is “the proceeds to be obtained from the [sale] vis-à-vis any appraisals of the property.”

Ultimately, though, any attempt to determine a business’s value is merely “an estimate of the present value of the business’s future earning capacity” and thus requires subjective predictions about the future. In the context of a bankruptcy hearing, the valuation is even less optimal as the decision is ultimately made by “a single, nonexpert judge” relying on “the testimony of experts who, far from being impartial, are advocates for competing interests.”

A §363(b) hearing where time is of the essence—as was the case in Chrysler—is a particularly ripe setting for parties to

124 Id.
126 In re Lionel Corp., 722 F.2d at 1071.
127 Baird & Bernstein, supra note 117 at 1941-42.
128 Id. at 1936.
manipulate the valuation process for their own gain, since, due to time limitations, the court may have to rely on the debtor’s own valuation of its assets—a valuation likely to be influenced by those claimholders with the greatest leverage against the debtor. The result in such scenarios will be that a court is likely to accept as accurate a valuation that undervalues the debtor’s actual going concern or liquidation value. The consequence of undervaluing a business or its assets is that a §363(b) sale for less than the business’s actual going concern value (but greater than or equal to the appraised value) will satisfy Lionel’s business objective test.

Such a disposition for less than the debtor’s actual going concern value leaves the remaining value not paid to the debtor to be divided between the buyer and those claimholders who were able to use their leverage against the debtor and influence the debtor’s valuation. In this manner, the Second Circuit’s application of Lionel’s business objective test to §363(b)’s *sub rosa* plan prohibition allows the section to be used as a loophole to the protections afforded by §1129 and the rest of Chapter 11 and permit more powerful junior claimholders to exert pressure on debtors in order to recover distributions of a debtor’s going concern value—precisely the concern the Senate Judiciary Committee expressed when the Bankruptcy Reform Act was proposed and which the Second Circuit in Lionel intended its holding to prevent.129

The Chrysler sale may have been such a transaction. In Chrysler, the court relied on the testimony of the debtor’s valuation expert regarding the debtor’s liquidation value—despite the expert’s conflict-of-interest and despite the funds’ lack of an opportunity to prepare its own valuation—to conclude that since the sale price was higher than the expert’s claimed liquidation value, the purchase price was fair and the sale

129 *In re Lionel*, 722 F.2d at 1070 (quoting S. Rep. No. 95-989 at 10, 95th Cong. 2d Sess. 9 (1978)).
served the good business objective of maximizing the debtor’s estate. The court thus concluded that the distributions by the buyer directly to Chrysler claimholders must be on account of, and in consideration of, contributions by those claimholders of new value and not their pre-bankruptcy claims. Because of the limitations of business valuation in the bankruptcy context, it is impossible to know whether those distributions truly were solely on account of new value.

So, the greatest weakness of the Second Circuit’s treatment of the sub rosa plan prohibition is that it has no way of distinguishing between transactions involving the buyer and a claimholder of the debtor that are made solely on account of a contribution of new value from the claimholder and those made, at least in part, on account of the claimholder’s pre-petition claim against the debtor. A simple solution to this problem would be a prophylactic rule that prohibited a §363(b) sale whenever there was an agreement between a buyer and a claimholder at the time of the sale. Such a rule would leave the buyer free to negotiate with the claimholder after the sale but would remove the incentive for a claimholder to exert influence on the debtor in order to secure a lower purchase price in return for a distribution representing a portion of the debtor’s going concern value. And such a rule would prevent the use of §363(b) sales to reallocate the distribution of the value of a debtor’s assets thereby altering claimholders’ post-bankruptcy positions—the real intent of the sub rosa prohibition espoused in Braniff.

d) The Source of Disagreement Identified

The Second and Fifth Circuits were split on exactly what transactions the prohibition against sub rosa plans forbid. The good business reason test the Second Circuit followed and which it applied in Chrysler not only conflated the prohibition against sub rosa plans
espoused by Braniff with the business justification requirement espoused by Lionel, it also turned §363(b) sales into a loophole that powerful claimholders acting in conjunction with buyers could take advantage of to usurp portions of the debtor’s going concern value away from the debtor’s estate—an outcome Congress in proposing the Bankruptcy Code had explicitly intended to preclude and which would greatly increase the cost of capital to businesses.\textsuperscript{130} Thus, it seems fair to conclude that if the Supreme Court’s decision was intended to signal a disagreement with some portion of the Second Circuit’s decision in Chrysler, as the evidence suggests it was, the portion most likely drawing the Court’s criticism was the court of appeals’ analysis of §363(b) and its application of the sub rosa plan prohibition.

IV. Why did the Court Wait Six Months to Vacate the Court of Appeals?

If the Court’s December opinion really was motivated by disapproval of the Second Circuit’s interpretation of §363 and a desire to prevent the court of appeals’ decision from serving as a precedent in future cases, at least one question still remains: why did the court not state this disapproval in June when Chrysler’s case was first brought to its attention? This question is a difficult one. The answer could simply be that because the Second Circuit did not release a written opinion until August, after the sale had already closed, the Court was unaware of the court of appeals’ rationale for approving the sale but chose to defer to the lower court and trust its judgment.\textsuperscript{131} Or, the answer could be that even in June the Court did not believe Chrysler’s sale complied with the requirements of the Bankruptcy Code but, for prudential reasons, chose to permit the sale to close and to address the case later in order to prevent the Second Circuit’s

\textsuperscript{130} see infra Part IV.A.
\textsuperscript{131} But see In re Chrysler LLC, 2009 U.S. App. LEXIS at 12351 (Second Circuit’s order affirming the bankruptcy court’s sale order “for substantially the reasons stated” by the bankruptcy court).
interpretation of the Code to provide a loophole in future bankruptcy cases. Below, I discuss two such potential “prudential reasons”. Ultimately, however, it is probably impossible to know exactly why the Court acted in the way it did. It is also important to keep in mind that the nine justices may have each had different reasons for choosing the course of conduct they did.

A. Special Times Require Special Laws

One possible explanation for the Court’s choice to permit the sale to close and express its disapproval only six months later is that the Court felt—given the extraordinary circumstances and the national interests involved in Chrysler’s bankruptcy case and those of other companies in the auto industry—\(^{132}\) that while the sale of Chrysler’s assets may not strictly comply with the Bankruptcy Code’s requirements, it was necessary that the courts grant the sale an exception and allow it to close, thereby avoiding the potentially severe economic repercussions that could have arisen from a total collapse and liquidation of Chrysler. Once the sale (and the sale of GM’s assets to “New GM”) had closed and could not be undone, the Court ensured §363(b) could not serve as a loophole to Chapter 11’s requirements in future bankruptcies by vacating the Second Circuit’s opinion, thereby preventing it from having precedential effect.

If this was the Court’s actual motivation, it arguably would not be the first time the Court made a decision influenced as much by the political or economic climate at the time as by the text of the relevant law. Such seminal cases as Dred Scott v. Sandford. \(^{133}\)

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\(^{132}\) See Ashby Jones & Mike Spector, Creditors Cry Foul at Chrysler Precedent, WALL ST. J., June 13, 2009, at B1 ([Peter Kaufman, president of investment bank Gordian Group LLC, said, “The excuse that [the auto cases] are ‘special circumstances,’ I’m sure [is] right until the next time it’s a ‘special circumstance.’”]).

\(^{133}\) Dred Scott v. Sandford, 60 U.S. 393 (1857).
West Coast Hotel v. Parrish\textsuperscript{134} and Korematsu v. United States\textsuperscript{135} can arguably be explained as reactions to the context surrounding the case. In Dred Scott, the Court was certainly aware of and likely influenced by the heated conflict regarding slavery’s legality that was dividing the country. It is thus possible the Court’s ruling in that case was as much an attempt to solve the conflict over slavery as a simple interpretation of the relevant statutory and constitutional provisions.\textsuperscript{136} Likewise, the Court’s decision in West Coast Hotel overturning its precedent regarding the extent the Constitution permitted governments to regulate the economy was possibly influenced by the Great Depression’s effect on the country’s economy (an argument Justice Sutherland made in his dissent).\textsuperscript{137}

And in Korematsu, the Court’s ruling that the internment of Japanese-Americans was not unconstitutional was almost certainly influenced by the fact the country was at war.\textsuperscript{138}

Chrysler’s bankruptcy was not a moment of the same national import as the build-up to the Civil War, the Great Depression or World War II, but it was a time of economic uncertainty, the likes of which the country, arguably, had not seen since the 1930s. In the months leading to Chrysler’s bankruptcy filing, the Dow Jones Industrial Average had reached a low of 6626.94, a drop of over 52% from its record high of 14,093 in June.

\begin{footnotes}
\footnote{West Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937).}
\footnote{Korematsu v. U.S., 323 U.S. 214 (1944).}
\footnote{See Gerard N. Magliocca, Preemptive Opinions: The Secret History of Worcester v. Georgia and Dred Scott, 63 U. Pitt. L. Rev. 487, 570-71 (2002) (suggesting Dred Scott was an attempt by Democrats and slaveholders to stave off the influence of a Republican party so intent on abolishing slavery so as to jeopardize the stability of the Union); Korematsu, 323 U.S. at 247-48 (Jackson, J. dissenting) (criticizing the majority for allowing military necessity to justify issuing an opinion upholding “a military expedient that has no place in law under the Constitution.”).}
\footnote{West Coast Hotel Co., 300 U.S. at 402-03 (Sutherland, J. dissenting). See also Cass R. Sunstein, Lochner’s Legacy, 87 Colum. L. Rev. 873, 881 n.42 (1987).}
\footnote{LR articles discussing... any explicit references in the opinion referring to the extraordinary circumstances due to WWII}
\footnote{Also see: Mark Thushnet, Defending Korematsu?: Reflections on Civil Liberties in Wartime, 2003 Wis. L. Rev. 273, 300 (2003) (arguing that judges’ reaction when faced with an emergency which the law does not permit those actions “policy-makers deem necessary to respond to the perceived emergency” is to “‘interpret’ the [law] to allow the actions.”).}
\end{footnotes}
2007. The country’s unemployment rate was 9.4%, the highest rate in over 20 years. The United States’ real gross domestic product had decreased for two consecutive quarters—a 6.3% decrease in the fourth quarter of 2008 and a 6.1% decrease in the first quarter of 2009. If Chrysler were broken up, the company’s nearly 55,000 employees would further swell the unemployment rolls. Thus, it is possible the Court felt the country’s economy was in such peril that it was necessary to bend the rules or permit exceptions in order to allow those programs designed by Congress and the Obama Administration to curtail the recession’s effects to serve their purpose. After the Treasury-guided “sales” of Chrysler and GM were complete, the Court closed the potential loophole to §363 the Second Circuit’s interpretation of the Code in Chrysler created by vacating that opinion in its December ruling.

B. Avoiding Confrontation with the Political Branches

Another explanation for the Court’s decision to permit the sale to close only to vacate the Second Circuit’s decision six months later is that the Court wished to avoid a highly publicized conflict with the President. Under this theory, the Court, fearful that President Obama and the Treasury might ignore an order by the Court staying the sale in order to prevent Fiat from walking away and Chrysler from having to resort to liquidation, instead refused to grant the Indiana funds’ application for a stay despite the Court’s uneasiness regarding the Second Circuit’s analysis of §363. Thus, the Court avoided a potential scenario where a political branch expressly disobeyed an order of the

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142 *In re Chrysler LLC*, 576 F.3d at 126.
Supreme Court, thereby seriously undermining the Court’s legitimacy. Months after the sale had closed, the Court was able, in its December ruling, to express its disapproval with the Second Circuit opinion—thereby limiting that ruling’s precedential effect—without drawing the ire of the President and jeopardizing the Court’s status.

If indeed this was what motivated the Court, it would not be an unprecedented strategy for the Court. In fact, as early as Marbury v. Madison, the Court has shown an uncanny ability to reach holdings that prevent the Court from coming into direct conflicts with the political branches that might jeopardize the Court’s legitimacy. In Marbury, Justice Marshall, after declaring that President Jefferson’s refusal to deliver the petitioner’s commission was illegal, ultimately concluded the Court lacked jurisdiction to hear the case and thus could not order the Executive Branch to deliver the commission, an order it was unclear whether the President would choose to obey if made.

The Supreme Court may have been following a similar strategy in 1937 when it shifted stances and began to uphold much of the New Deal legislation it had previously overturned, only after President Franklin Roosevelt proposed a bill that would have expanded the size of the Court to 15 justices allowing Roosevelt to appoint six new justices whose ideologies more closely aligned with his own. Such a bill, by allowing the political branches to pack the Court as a way of ensuring legislation would not be overturned, would have greatly compromised the Court’s independence. Soon after Roosevelt proposed the bill, the Court announced its decision in West Coast Hotel, which

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143 Marbury v. Madison, 5 U.S. 137 (1803).
144 Gordon S. Wood, Professor Of History, Brown University, The Origins of Judicial Review Revisited, or How the Marshall Court Made More out of Less (Oct. 9, 2008), in 56 WASH & LEE L. REV. 787 (arguing the Court not only in Marbury but repeatedly through late 18th and early 19th century avoided questions likely to lead to conflict w/ political branches).
signaled the Court’s acceptance of Roosevelt’s theory of the government’s power to regulate the freedom of individuals to contract.\footnote{The Court’s shift was mainly due to Justice Owen Roberts’ own shift. Previously a member of majority opinions in which the Court struck down New Deal legislation, Roberts, in West Coast Hotel, shifted stances and voted to overturn the Court’s prior ruling in order to uphold the government economic regulation in question. As a result of Roberts’ shift, as well as the retirement of Justice Van Devanter (one of the so-called “Four Horsemen” who regularly voted to strike down New Era legislation), the court packing measure was no longer needed to ensure New Deal legislation would not be struck and the bill quietly died without being put to a vote. \textit{But see:} MARIAN C. McKENNA, FRANKLIN ROOSEVELT AND THE GREAT CONSTITUTIONAL WAR: THE COURT-PACKING CRISIS OF 1937 419 (2002) (arguing Roberts decided to overturn the Court’s previous ruling a year earlier and was not influenced by the court-packing bill).}

In the Chrysler bankruptcy, the Court, as in the examples discussed above, was faced with a President determined to meet his objective. Practically from the moment he was elected, President Obama and his administration played an active role in Chrysler’s efforts to restructure itself and were determined to implement a plan that would allow Chrysler to become viable once again and continue operating.\footnote{See supra Part I.A; Matthew Dolan, et al., \textit{Auto-Industry Crisis Tests Obama}, WALL ST. J., Nov. 8, 2008, available at http://online.wsj.com/article/SB122606964550108607.html?mod=testMod.} Given the President’s active role in the company’s restructuring efforts and his sharp words regarding the treatment of Chrysler’s secured creditors,\footnote{see Press Release, The White House, \textit{supra} note 16. (President Obama labeling dissenting secured creditors as “speculators” and stating “I don’t stand with those who held out when everybody else is making sacrifices.”).} the Supreme Court may have felt that any action that held up or prevented the sale from closing would draw criticism or even outright rejection from the President. In addition, the President’s remarks when announcing Chrysler’s bankruptcy, made clear his view that he felt Chrysler’s restructuring strategy complied with the Bankruptcy Code and would be a “quick” and “efficient” bankruptcy.\footnote{\textit{Id.}} Thus, even if the Court disagreed with the Obama administration’s interpretation and felt the sale violated the Bankruptcy Code, it likely was not eager to present President Obama with a choice between obeying an order of the
Court that would effectively force Chrysler to liquidate and disobeying a Court order in order to prevent such an outcome and save thousands of Chrysler employees’ jobs.

However, for every example of a case where the Supreme Court’s decision may have been influenced by a desire to avoid a conflict with the political branches, there is an example where the Court handed down a decision that directly conflicted with the positions of one of the political branches. Two notorious examples of such cases are Youngstown Sheet & Tube Co. v. Sawyer—where the Court ordered President Truman to yield control of the steel factories he had ordered the government to seize during the Korean War—and U.S. v. Nixon—where the Court ordered President Richard Nixon to hand over tapes which contained incriminating evidence that were certain to lead to the President’s removal from office. In both cases, the Court rejected the Executive Branch’s claim of authority and ordered a President to take action to which he strongly objected, showing the Court was not afraid to issue a legal ruling directly conflicting with the President’s position.

While the U.S. economy was in a vulnerable position in the Spring of 2009 and Chrysler’s survival was considered by the Obama administration to be important to the economy’s recovery, it would be very difficult to argue that the importance of Chrysler’s restructuring reached the level of national importance as the situations facing the Court in the cases above. Thus, while the nine justices’ decision to permit Chrysler’s sale to close may have been influenced in part by a lack of desire to create confrontation with the Obama administration, it seems unlikely that if a majority of the Court did not believe the Chrysler sale was legal they would have permitted it to close. Still, it is possible that the

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Supreme Court’s decision to permit the Chrysler sale to close was motivated by a desire to avoid a conflict with the political branches.

IV. The Supreme Court and Second Circuit Opinions: Precedent and Effect

A. Effect of the Second Circuit Opinion

It would be difficult to understand the effect of the Supreme Court’s ruling going forward, without first grasping what the effects of the Second Circuit’s opinion—both its precedential effect on bankruptcy law and its effect on capital markets—would have been if the Supreme Court had not later stepped in.

1. Second Circuit Opinion as Precedent

Unsurprisingly, the Bankruptcy Court for the Southern District of New York, when evaluating whether to grant General Motor’s motion to sell substantially all of its assets through §363(b) in a sale virtually identical to Chrysler’s §363 sale, cited to its opinion granting Chrysler’s sale.\(^\text{152}\) The court in the GM case stated that *stare decisis* required it to follow the law articulated by the bankruptcy court and upheld by the Second Circuit in *Chrysler*\(^\text{153}\). Likewise, in August, the same court cited and followed the Second Circuit’s *Chrysler* opinion in approving a §363 sale of substantially all of the assets of an auto parts maker.\(^\text{154}\) There is only one other reported opinion that cites the Second Circuit’s decision in *Chrysler*.\(^\text{155}\) One should note that of the three cases citing the

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\(^\text{152}\) In re General Motors Corp., 407 B.R. 463 (Bankr. S.D.N.Y. 2009) (Citing In re Chrysler LLC, 405 B.R. 84) (Note: this case was decided prior to the release of the Second Circuit’s opinion and thus this decision cites to the Bankruptcy Court’s opinion instead).

\(^\text{153}\) In re General Motors Corp., 407 B.R. at 475, 505 (“On this issue, it is not just that the Court feels that it should follow Chrysler. It must follow Chrysler. The Second Circuit’s Chrysler affirmance, even if reduced solely to affirmance of the judgment, is controlling authority.”).


\(^\text{155}\) In re Humboldt Creamery, LLC, 2009 Bankr. LEXIS 2470, 3-4 (Bankr. N.D. Cal. 2009) (citing In re Chrysler LLC, 576 F.3d at 114) (citing the Second Circuit’s “melting ice cube theory” in an order approving a §363 sale. Ironically, the assets being sold in the case included ice cream and other frozen food items that would actually melt and decline in value if the sale as not approved quickly.).
Chrysler decisions, two involved debtors who were part of the faltering U.S. auto industry. Thus, these courts’ adherence to Chrysler in these cases may have been the result of the bankruptcy court giving special treatment to cases involving the auto industry during a time of great difficulty for that industry.\textsuperscript{156} Regardless, while courts may not have widely embraced the Second Circuit’s interpretation of §363(b) as enunciated in Chrysler, the decision did have at least some precedential effect prior to the Supreme Court’s December decision.

2. Second Circuit Opinion’s Effect on Capital Markets

In the months following the Second Circuit’s decision to uphold the sale, legal scholars released a flurry of articles debating the ramifications of the sale.\textsuperscript{157} Professors Roe and Skeel blasted the Second Circuit’s ruling, likening it to 19\textsuperscript{th} century receivership cases in its willingness to permit insiders and favored creditors to profit at the expense of disfavored parties.\textsuperscript{158} They also lamented the detrimental effect the decision would have on U.S. capital markets, warning that lenders would react to the decision by raising interest rates and refusing to extend financing to high-risk borrowers.\textsuperscript{159} Other commentators disagreed and posited that the Second Circuit’s opinion simply exposed the leverage DIP financers (in Chrysler’s case, the U.S. Treasury) always had to affect a speedy auction of a debtor, even at the expense of senior claimholders.\textsuperscript{160}

Even if these professors arguments are correct and the Second Circuit’s holding was the right decision and did not change the way courts applied §363, the response of the

\textsuperscript{156} see Ashby Jones & Mike Specter, supra note 132.
\textsuperscript{157} e.g. A. Joseph Warburton, supra note 83; Mark J. Roe & David A. Skeel, supra note 3; Stephen J. Lubben, No Big Deal: The GM and Chrysler Cases in Context, 83 Am. Bankr. L.J. 531 (2009); Ralph Brubaker & Charles Jordan Tabb, supra note 71.
\textsuperscript{158} Mark J. Roe & David A. Skeel, supra note 3 at 36.
\textsuperscript{159} Id. at 38. See also Nicole Bullock, supra note 2; Lou Whiteman, supra note 2.
banking community and financial experts like Warren Buffet (as well as that of a substantial number of academics in the bankruptcy field) indicates that the Second Circuit’s interpretation of §363(b) diverged from the lending industry’s own understanding of the Code. They argued that the structure of the Chrysler sale undermined Chapter 11’s protections and warned that if courts approved such transactions under §363(b), it would increase lenders’ uncertainty as to their rights under the bankruptcy law by permitting asset sales to effectively subordinate the priority of secured, senior creditors. Due to this increased uncertainty, first priority lenders would likely react by increasing the interest rates charged for secured loans—thereby increasing the cost of capital for companies—and increasing the amount of control they exercised over borrowers. The resulting impact on the economy from such an increase in the cost of capital alone “could be substantial.” The effects of creditors exerting greater control over business lenders would likely include companies feeling pressured to make conservative and sub-optimal decisions in order to appease their creditors’ by protecting their interests rather than acting in a way to best promote the interests of the company and its shareholders. Interpreting §363 to allow asset sales like Chrysler’s would also incentivize secured creditors’ to act more quickly in seizing collateral (rather than negotiating with debtors in financial trouble) in order to avoid potentially having their claims against the debtor effectively subordinated to junior claimholders during the bankruptcy process through a §363 sale.

B. Effect of the Supreme Court’s December Ruling

161 Nicole Bullock, supra note 2; Whiteman, supra note 2.
162 A. Joseph Warburton, supra note 83 at 31 (citing Harvey R. Miller & Shai Y. Waisman, Is Chapter 11 Bankrupt?, 47 B.C. L. Rev. 129, 170-71 (2005)); see also Nicole Bullock, supra note 2.
163 Nicole Bullock, supra note 2.
164 A. Joseph Warburton, supra note 83 at 32.
So what does the Supreme Court’s December opinion mean going forward? First, it prevents the Second Circuit’s opinion upholding the bankruptcy court’s sale order from serving—as it did in GM’s bankruptcy case—as a controlling precedent in future cases. In fact, since the Supreme Court vacated the Second Circuit opinion in December, no court has cited the case as precedent in a reported opinion.\(^{165}\) Thus, a future debtor should not assume a bankruptcy court will permit it to sell its assets in a transaction similar to the sale in Chrysler (i.e. a §363(b) sale of substantially all the debtor’s assets to a shell corporation that also agrees to make payments to junior claimholders of the debtors). However, the Supreme Court’s opinion does not prevent the court of appeals’ decision from having persuasive effect on a future case. To understand why, it is important to understand the holding in Munsingwear, the case the Court cited in its December opinion.

In United States v. Munsingwear,\(^ {166}\) the Supreme Court determined that a trial court’s decision, an appeal of which was dismissed for mootness, would still have res \textit{judicata} effect so as to prevent relitigation of the same questions of fact. In explaining its decision, the Court stated:

\begin{quote}
The established practice of the Court in dealing with a civil case from a court in the federal system which has become moot while on its way here or pending our decision on the merits is to reverse or vacate the judgment below and remand with a direction to dismiss... That procedure clears the path for future relitigation of the issues between the parties and eliminates a judgment, review of which was prevented through happenstance. When that procedure is followed, the rights of all parties are preserved; none is prejudiced by a decision which in the statutory scheme was only preliminary.\(^ {167}\)
\end{quote}

\(^{165}\) According to a LEXIS search.


\(^{167}\) Munsingwear, 340 U.S. at 40.
Note that Munsingwear stated, when addressing an appeal that had become moot, the Court was free to either “reverse or vacate the judgment.”168 Given that the court had this option when deciding how to handle the Indiana funds’ appeal, it seems telling that the Court chose to vacate rather than reverse. While a reversal would have been an explicit rejection of the Second Circuit’s holding, the Court’s decision to vacate seems to leave the legal issues raised in the appeal open to be argued again in the future.

According to the Court’s holding in Munsingwear, the effect of the December 14 ruling should be to prevent the Second Circuit’s opinion in the Chrysler case from controlling or governing any future case in the Second Circuit raising similar issues. However, especially in the Second Circuit, the opinion still probably has precedential value. As Professor Lubben commented, “…a Bankruptcy Court would have to be extremely self confident to go against a Circuit Court opinion that was not reversed on the merits.”169 Thus, because the Supreme Court only vacated the court of appeals’ opinion and did not reverse the opinion on its merits, bankruptcy courts in the Second Circuit are likely to follow the court of appeals’ interpretation of §363(b) in Chrysler to determine compliance with the section. In other circuits, courts addressing the question, while free to reach a ruling that conflicts with the Second Circuit’s decision in Chrysler, are likely to at least look at the Second Circuit’s opinion when crafting their own decisions. Thus, the effect of the Supreme Court’s ruling is to leave the door open for relitigation of the legality of the type of sale Chrysler employed.

In the meantime, lenders remain uncertain as to whether bankruptcy courts will allow their claims to be effectively subordinated through §363(b) sales. While the

168 Id.
automakers’ reorganizations may have been special cases meriting looser adherence to §363’s requirements, as a result of the Second Circuit’s holding and the Supreme Court’s decision vacate reverse rather than reverse that holding, some uncertainty still remains as to whether §363(b) can be used as a loophole to Chapter 11’s provisions and whether sales similar to Chrysler’s will be permitted in the future.

V. Conclusion

In this paper, I set out to answer two questions: (1) What was the effect of the Supreme Court’s December decision in the Chrysler case? and (2) Why did the Court wait until six months after the Chrysler sale had closed to make its decision? While even after a close analysis it is impossible to answer those questions without being able to read the justices’ minds, this paper has offered a likely explanation for the first question and possible explanations for the second.

The effect of the Supreme Court’s decision was to prevent the Second Circuit’s decision in Chrysler from serving as a controlling precedent in the future. The most likely reason the Court felt compelled to vacate the Court of Appeals’ decision was an uneasiness with the Second Circuit’s interpretation of §363(b) and its application of that section’s prohibition against sub rosa plans. The Second Circuit in Chrysler, as it had done in an earlier case, conflated the prohibition against sub rosa plans announced in Braniff, with the business justification requirement announced in Lionel. The concern of Lionel’s business justification requirement was maximizing and preserving the value of the debtor’s assets and estate. In contrast, the concern of Braniff’s prohibition of sub rosa plans was ensuring the value in the debtor’s estate was distributed, not according to private agreements between claimholders and/or outside buyers, but according to the
rules of Chapter 11. The Second Circuit, in *Chrysler*, erred in conflating the two and limiting *Braniff*’s holding as prohibiting only those sales that reallocate the debtor’s value by explicitly dictating the terms of a reorganization plan, rather than any sale that redistributes the debtor’s value among claimholders. The Supreme Court’s December decision is best explained as the Court recognizing this error by the Second Circuit (and the detrimental effects that might follow from such an interpretation of the Code) and vacating the *Chrysler* opinion in order to prevent this interpretation from becoming an accepted precedent.

Explaining why the Court waited six months after the *Chrysler* sale had closed to announce this disapproval with the Second Circuit’s formulation of §363(b)’s requirements is more difficult. Possible explanations are (1) the Court felt the *Chrysler* sale was too important to the nation’s economic stability to strike down, (2) the Court lacked the will to create a conflict with the political branches which had publicly announced their support for the sale, (3) the Court felt the sale complied with §363(b) even if it disagreed with the bankruptcy court’s and Second Circuit’s interpretation of that section’s requirements and (4) the Court only became aware of the Second Circuit’s flawed application of §363(b) after the sale had closed when the Court of Appeals released its decision in August.

While it is unclear exactly what motivated the Supreme Court to vacate the opinion upholding the sale only six months after the sale had closed, the true explanation has little effect on the December opinion’s impact on bankruptcy and business reorganizations going forward. In future reorganizations, interested parties should not assume they will be able to use §363(b) to essentially effectuate a reorganization plan
without complying with all of Chapter 11’s requirements. Buyers proposing sales like that in *Chrysler* that contemplate payments or distributions to claimholders of the debtor should not assume courts will approve those sales so long as the sales serve some business purpose. Instead, such buyers (and claimholders), should be wary that a court will rule such sales amount to *sub rosa* plans and are impermissible. Thus, the effect of the Supreme Court’s December decision is to close the loophole to Chapter 11 that §363(b) had become by signaling that courts analyzing the validity of a proposed sale must focus not only on whether a sale maximizes the value of the debtor’s estate, but also whether a sale redistributes any portion of the value of the debtor’s estate to the debtor’s claimholders.