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# ABI Commission Testimony
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Thank you very much for inviting me to discuss Chapter 11 with you today.

I wanted to start by thanking all of you -- the Commissioners and the American Bankruptcy Institute -- for organizing this. I think it's an extremely important project. And, specifically, I want to thank Michelle Harner and Sam Gerdano, who are doing a great job of managing the whole process.

Most of my work since leaving law school in 1989 has involved bankruptcy and insolvency, first as a California lawyer and later as a Tennessee lawyer and law professor. As a lawyer I have represented creditors, committees, debtors, and trustees – creditors mainly in large cases and debtors in middle-market and small cases. As a professor, I teach a variety of business law courses, including a chapter 11 seminar, and research and write about bankruptcy-related topics.

I am also serving as the reporter for the Commission's Committee on Plan Process and Substance.

That said, all these remarks are made in my individual capacity and constitute my own opinions, not those of any of the groups with which I am affiliated.

## Summary

There are two areas that I believe should be the focus of chapter 11 reform. Reducing reorganization costs in small to middle market cases and instituting a uniform structure and process for section 363 sales of substantially all the assets of a debtor. Essentially, I think that the plan process in all cases needs to be streamlined and sped up to decrease transactions costs and the 363 sale process needs to be slowed down to promote more robust disclosure and exposure of the assets in question to the market.

## I. Reducing Administrative Costs and Burdensome Deadlines in Middle Market and Smaller Cases

### A. Introduction

Current provisions in Chapter 11 of the Bankruptcy Code related to the conformation of re-organization plans are ripe for revision. The number of middle market and smaller business entering Chapter 11 and emerging as viable enterprises is falling. Administrative costs for plans in middle market and smaller cases are too high and as a result debtors are increasingly relying on numerous alternatives to the traditional Chapter 11 process. The benefits sought by the 1978 code revisions through disclosure and disclosure statements are largely unrealized.[1] The current

[1] Jeffrey A. Wurst, *Is Chapter 11 Still a Viable Option – Or Has High Cost Rendered the Process Unaffordable?*, RMFPC.COM, http://rmfpc.com/wp-content/uploads/2013/03/Wurst-ABFJ-Mar-2013.pdf (last visited October 27, 2013).

two-step disclosure statement and plan confirmation process is unduly expensive and time consuming. The disclosure time tables applicable in small business cases are unrealistically short and unobtainable for many debtors. One possible means of addressing these problems is making the current small business provisions in the code combining the disclosure statement hearing and plan hearing available on an optional basis to all debtors and extending or eliminating the deadlines imposed on those that are currently classified as small business debtors. It is unlikely that many larger debtors would elect small business treatment as they would recognize the need for creditors' committee involvement and a two-step disclosure statement/plan confirmation process. Extending the applicability of the small business provisions would more effectively accomplish the objectives of Chapter 11 in the middle and smaller cases largely through streamlining procedures and reducing administrative costs while allowing sufficient time to negotiate with creditors, fix operational problems, and confirm a plan of reorganization.

B. The Disclosure Statement and Disclosure Statement Hearing.

The debtor has an exclusive right to file a plan of reorganization within 120 days from the date the petition is filed.[2] This time period may be extended for an additional 60 days upon an order of the court.[3] Chapter 11 requires that a disclosure statement be approved by the court after notice and a hearing before votes on a plan are solicited.[4] The disclosure statement is a document that contains adequate information concerning the assets, liabilities, and business affairs of the debtor sufficient to enable a creditor to make an informed judgment about the debtor's plan of reorganization.[5] Although local rules and the U.S. Trustee guidelines in some jurisdictions provide specific requirements, there is generally no specific set of requirements that defines the

[2] 11 U.S.C. § 1121(b) (2012).

[3] 11 U.S.C. § 1121(d) (2012).

[4] Fed. R. Bankr. P. 3017 advisory committee note.

[5] *See* 11 U.S.C. § 1125(a)(1) (2012); Hon. Barbara J. Houser, *Disclosure Statements; Confirmation and Cramdown of Chapter 11 Plans*, SS029 ALI-ABA 471, 475-76 (2011) ("Since the enactment of the Bankruptcy Code, courts have developed nineteen factors for evaluating the adequacy of the information contained in the disclosure statement. The most commonly cited version of the list of factors appears in *In re Metrocraft Publ'g Servs*., Inc., 39 B.R. 567 (Bankr. N.D. Ga. 1984). Borrowing factors from other cases, and adding a few of its own, the *Metrocraft* court listed nineteen factors for courts to consider when determining the adequacy of information in a proposed disclosure statement: 1. the circumstances that gave rise to the filing of a bankruptcy petition; 2. a description of the available assets and their value; 3. the anticipated future of the company; 4. the source of information stated in the disclosure statement; 5. a disclaimer (i.e., a statement indicating that no statements or information concerning the debtor or its assets or securities are authorized other than those made in the disclosure statement); 6. the present condition of the debtor while in chapter 11; 7. the scheduled claims; 8. the estimated return to creditors under a chapter 7 liquidation; 9. the accounting method utilized to produce financial information and the name of the accountants responsible for such information; 10. the future management of the debtor; 11. the chapter 11 plan or a summary thereof; 12. the estimated administrative expenses, including professional fees; 13. the collectibility of accounts receivable; 14. financial information, data, valuations or projections relevant to the creditors' decision to accept or reject the chapter 11 plan; 15. information relevant to the risks posed to creditors under the plan; 16. the actual or projected realizable value from recovery of preferential or otherwise voidable transfers; 17. the existence, likelihood, and potential for recovery in nonbankruptcy litigation; 18. tax consequences of the plan; and 19. the relationship of the debtor with affiliates.
*See In re* Metrocraft Publ'g Servs., Inc., 39 B.R. at 568; *see also In re* U.S. Brass, 194 B.R. 420, 424 (Bankr. E.D. Tex. 1996); *In re* Cardinal Congregate I, 121 B.R. 760, 765 (Bankr. S.D. Ohio 1990)").

information that is adequate to satisfy this Code requirement.[6] A plan proponent should make every effort to include adequate information in the disclosure statement, however, more is not necessarily better. A disclosure statement should be clear and succinct,[7] and approval of the disclosure statement has been denied where a disclosure statement is too complex and confusing.[8] That said, because the adequacy of the disclosure statement is a subjective determination made by the court,[9] there is a notable "everything but the kitchen sink" approach to disclosure statement drafting, and some seem to pattern their disclosure statement on the SEC's prospectus requirements.[10]

The purpose of the disclosure statement hearing is to determine whether the proposed disclosure statement contains adequate information and, hence, whether it should be approved by the court for dissemination to creditors and equity interest holders.[11] However, disclosure statement hearings are often used by dissenting creditors as a vehicle for asserting that information already known to them be included and for bringing what really are disguised (or not) objections to confirmation of the proposed plan of reorganization.[12]

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[6] HON. WILLIAM L. NORTON JR. & WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW AND PRACTICE, 5 Norton Bankr. L. & Prac. 3d § 97:35 (2013).
[7] *In re* Radco Properties, Inc., 402 B.R. 666, 678 (Bankr. E.D.N.C. 2009).

[8] *In re* Rodriguez Gas & Oil Svcs., Inc., No. 08–50152, 2008 WL 4533687, at *1 (Bankr. S.D. Tex. Oct. 2, 2008) (denying approval of 51-page disclosure statement in case with 9 creditors, where the disclosure statement was "so tedious and so packed with unnecessary information that the court was unable to dig out relevant, useful data without extraordinary effort," and noting that "unnecessary information merely obfuscates, it does not add value"); *In re* J.D. Mfg., Inc., No. 07-36751, 2008 WL 4533690 at *2 (Banrk. S.D. Tex. Oct. 2, 2008) ("very simple plans with few creditors do not require complex, lengthy disclosure statements").

[9] *See In re* Texas Extrusion Corp., 844 F.2d 1142, 1157 (5th Cir. 1988)("[T]he determination of what is adequate information is subjective and made on a case by case basis. This determination is largely within the discretion of the bankruptcy court"); *In re* Phoenix Petroleum Co., 278 B.R. 385, 393 (Bankr. E.D. Pa. 2001) ("[I]t is also well understood that certain categories of information which may be necessary in one case may be omitted in another; no one list of categories will apply in every case.").

[10] BANKRUPTCY LAW FUNDAMENTALS, CHAPTER 12: THE CHAPTER 11 PLAN OF REORGANIZATION (2013), *available at* Westlaw 1 Bankruptcy Law Fundamentals § 12:9.

[11] *See* 11 U.S.C. § 1125(b) (2012).

[12] Houser, *supra* note 5, at 477-78 ("*See, e.g.*, In re M.J.H. Leasing, 328 B.R. 363 (Bankr. D. Mass. 2005) (observing that it is appropriate to consider an objection related to the capability of confirmation at a disclosure statement hearing); *In re* Felicity Assocs., 197 B.R. 12, 14 (Bankr. D.R.I. 1996) (observing that "it has become standard Chapter 11 practice that 'when an objection raises substantive plan issues that are normally addressed at confirmation, it is proper to consider and rule upon such issues prior to confirmation, where the proposed plan is arguably unconfirmable on its face"') (citations omitted); *In re* Bjolmes Realty Trust, 134 B.R. 1000 (Bankr. D. Mass. 1991) (observing that courts may rule on confirmation issues at the disclosure statement hearing when the plan is facially unconfirmable)") (citation omitted).

C. Issues Stemming from Disclosure Statement and Hearing Costs

Lengthy Chapter 11 cases (1) injure creditors by indefinitely delaying the debtor's obligation to pay creditors on account of their pre-petition claims;[13] (2) divert money that would otherwise be distributed to creditors on attorneys and other administrative expenses;[14] (3) allow the managers who created the debtor's financial problems to remain in control, drawing their salaries and retention bonuses at the expense of creditors;[15] (4) are not as efficient as the free market would be in solving the problems of insolvent companies;[16] and (5) otherwise impair the efficiency of the bankruptcy system.[17]

Increased leverage and rising administrative costs, such as those associated with the creation and dissemination of the disclosure statement, have pushed Chapter 11 bankruptcy for many debtors away from an effective means of re-organization and re-structuring toward what is in many cases a prolonged liquidation.[18] This is partly explained by the fact that Chapter 11 was fundamentally conceived for large businesses.[19] In the large businesses context, complex debt and asset structures arguably justify the SEC-style disclosures, multi-layered plans, voting and the like that characterize money-center Chapter 11 cases.[20] In small business cases, where the value added from increased disclosure is smaller relative to larger cases, the requirements of Chapter 11 pile on costs and can overly complicate the proceedings.[21] Additionally, the few small businesses that survive the reorganization gauntlet can emerge bankruptcy with 20 percent

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[13] Josef S. Athanas, *Expediting the Administration of the Estate in Chapter 11: The Case for Obtaining a Court-Approved Combined Plan and Disclosure Hearing*, 8 J. Bankr. L. & Prac. 103, 108 (1999) (*citing* Judge A. Thomas Small, *Small Business Bankruptcy Cases*, 1 Am. Bankr. Inst. L. Rev. 305, 305 (1993); Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 Wis. L. Rev. 729 (1993)).

[14] Athanas, *supra* note 13, at 108 (citing Small, *supra* note 13, at 305).

[15] Athanas, *supra* note 13, at 108 (citing John Greenwald, *The Bankruptcy Game*, TIME, May 18, 1992, at 60; Michelle Singletary, *Panel Votes to Form Bankruptcy Study Body*, WASH. POST, Mar. 20, 1992, at F1; LoPucki, *supra* note 13, at 729).

[16] Athanas, *supra* note 13, at 108 (citing Douglas G. Baird, *The Uneasy Case For Corporate Reorganizations*, 15 J. LEGAL STUD. 127, 127-8 (1986); James W. Bowers, *Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Theory and the Elementary Economics of Failure*, 88 Mich. L. Rev. 2097, 2141 (1990)).

[17] Athanas, *supra* note 13, at 108

[18] Daniel F. Dooley, *Viewpoint: Alternatives to Bankruptcy for the Middle Market*, DOW JONES: DAILY BANKRUPTCY REVIEW (Feb 26, 2013), http://www.morrisanderson.com/images/uploads/documents/Viewpoint_Dooley_Feb_27_13.pdf (last visited October 27, 2013).

[19] NAT'L BANKR. CONFERENCE, NORTON BANKR. LAW ADVISOR, A PROPOSAL FOR AMENDING CHAPTER 12 TO ACCOMMODATE SMALL BUSINESS ENTERPRISES SEEKING TO REORGANIZE, 2010 No. 2 Norton Bankr. L. Adviser 1 (2010).

[20] *Id.*

[21] *Id*.

or more of their assets consumed by administrative bankruptcy costs.[22] As a result, many lenders and buyers have come to shy away from the increasingly slow and costly Chapter 11 process.[23] Lenders are increasingly pushing debtors, especially small business debtors,[24] toward bankruptcy alternatives, including Assignments for Benefit of Creditors (ABCs),[25] Uniform Commercial Code (UCC) Section 9 foreclosure sales[26], State receivership,[27] and Federal receivership.[28] Each of these bankruptcy alternatives pose unique challenges. The process for ABCs, either judicial or through reliance on common law, differs by state.[29] UCC Section 9 sales are also state law dependent. State receiverships, traditionally used for real property in the period pending foreclosure, can be ill suited for distressed businesses.[30] Federal receiverships, though less costly, are lacking in process and guidelines.[31] Beyond the obvious point that a debtor employing a bankruptcy alternative is not afforded many of traditional protections of bankruptcy, emerging use of such alternatives causes debtors to face an unsure outcome and creditors to have to operate and assess risk and address uncertainty under the laws of multiple jurisdictions.[32] If the costs of a Chapter 11 proceeding are lowered, lenders and debtors alike would have diminishing motivations for pursing a bankruptcy alternative.

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[22] *Id.*

[23] PAUL R. HAGE, NORTON BANKR. LAW ADVISOR. A PRIMER ON BAPCA's SMALL BUSINESS BANKRUPTCY PROVISIONS, 2007 No. 9 Norton Bankr. L. Adviser 1 (2007).

[24] NAT'L BANKR. CONFERENCE, *supra* note 19 ("The model for Chapter 11 was the publicly-traded manufacturer, not the local diner. As a result, many distressed small businesses are forced to wind down using antiquated state-law procedures instead of Chapter 11.").

[25] *See* Mike C. Buckley & Gregory Sterling. *What Banks Need to Know About ABCs*, 120 Banking L.J. 48, 49 (2003) (describing an ABC's simplicity as a non-judicial, less costly process).

[26] David A. Warfield, *Analyzing The Trends in Distressed Asset Sales*, ASPATORE, December 2011, at 1, available at 2011 WL 6469934 (discussing Article 9 "friendly foreclosures" as an alternative to Section 363 sales).

[27] *Id.* at 3

[28] *Id*. at 3-4

[29] Buckley & Sterling, *supra* note 25, at 49.

[30] Warfield, *supra* note 26, at 3 (discussing the shortcomings of receiverships in relation to businesses generally).

[31] *Id.* at 4.

[32] This is precisely why section 363 sales of substantially all the assets of a business are so attractive to creditors – it really is a federal law uniform foreclosure mechanism that operates nation- or world-wide, wherever the assets may be. George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 Am. Bankr. L.J. 235, 267 (2002) ("[T]he dominant interpretation is that § 363(f) can be used to sell property free and clear of claims that could otherwise be assertable against the buyer of the assets under the common law doctrine of successor liability.").

D. Small Business Provisions in the Code

Enacted by Congress in 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCA") amended, among other provisions, the disclosure requirements for small businesses. Among the motivations behind the legislation was a desire to increase the efficiency of Chapter 11, particularly by reducing cost and delay in small business cases. The precise definition of "small business" has been hotly debated.[33] The Code defines a "small business debtor" as "a person engaged in commercial or business activities … excluding a person whose primary activity is the business of owning or operating real property… that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $2,490,925 [34] (excluding debts owed to 1 or more affiliates or insiders) [and] for a case in which the United States trustee has not appointed … a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor."[35] In general, a small business is closely held, owner operated, has liabilities backed by formal or informal personal guaranties, lacks the ability to afford substantial professional fees, and has under $5 million in revenues.[36] [37]

After BAPCA, small business debtors are provided a 180-day exclusivity period,[38] and are required to have filed a plan and disclosure statement within 300 days after entry of the order for relief.[39] Both deadlines are subject to extension, by motion.[40] The order must be "signed" before the deadline expires and must include a new deadline.[41] In support of the extension motion, the debtor must prove by a preponderance of the evidence that "it is more likely than not" that a plan will be confirmed "within a reasonable period of time."[42] BAPCA further mandates that, if the plan complies with the Code requirements, the court "shall confirm" the plan "not later than 45 days" after it is filed.[43] Section 1116 of the Code requires that the small business debtor file a

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[33] AM. BANKR. INST., THE SMALL BUSINESS IN CHAPTER 11 AFTER BAPCA, 316 (2010), http://www.abiworld.org/committees/newsletters/busreorg/vol9num4/small.pdf (last visited October 27, 2013).

[34] Dollar amount as adjusted by the Judicial Conference of the United States. *See* 11 U.S.C. §§ 101, 104 note Adjustment of Dollar Amounts. The dollar amount is next set to increase in 2016.

[35] 11 U.S.C. § 101 (51D)(A) (2012).

[36] AM. BANKR. INST., *supra* note 33, at 316.

[37] For an extensive examination of the definition of "small business debtor" *See* Anne Lawton, *An Argument for Simplifying the Code's "Small Business Debtor" Definition*, 21 Am. Bankr. Inst. L. Rev. 55 (2013).

[38] 11 U.S.C. § 1121(e) (2012); James B. Haines Jr and Philip J. Hendel, *No Easy Answers: Small Business Bankruptcy After BAPCPA*, 47 B.C. L. Rev. 71 (2005).

[39] 11 U.S.C. § 1121(e) (2012).

[40] *Id.*

[41] *Id.*

[42] *Id.*

variety of documents with the court at the time the voluntary petition is filed.[44] The debtor must "append" to the petition its most recent financial documents, including a balance sheet, statement of operations, cash-flow statement, and federal income tax return.[45] BAPCA also requires that the debtor deposit cash sufficient to offer "adequate assurance" to utility suppliers and to give administrative expense priority to claims for goods supplied within 20 days of the bankruptcy petition.[46] This is particularly significant to small businesses due to their typically increased borrowing constraints relative to larger businesses.[47] Plainly speaking, Sections 366(b) and 503(b)(9) increase the cost of Chapter 11 by forcing a small business to generate sufficient cash flow to cover these requirements immediately.[48]

BAPCA allows the court to approve a disclosure statement submitted on standard forms approved by the court or adopted under section 2075 of title 28.[49] BAPCA retains the option for a small business debtor to seek conditional approval of its disclosure statement,[50] with final approval to be considered at the confirmation hearing.[51] Additionally, the court may determine that the plan itself contains adequate information so that a separate disclosure statement is not required.[52] The availability of standard forms is an obvious time and cost saver.[53] The debtor's ability to gain conditional approval (without notice and hearing) of a disclosure statement is beneficial because it allows the debtor to solicit votes for a plan earlier than other Chapter 11

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[43] 11 U.S.C. § 1129 (2012).

[44] 11 U.S.C. § 1116 (2012).

[45] *Id.*

[46] *See* 11 U.S.C. §§ 366(b)(c), 503(b)(9) (2012).

[47] NAT'L BANKR. CONFERENCE, *supra* note 19.

[48] *Id.*

[49] *See* 11 U.S.C. § 1125(f)(2).

[50] Rule 3017.1 provides the procedure for the court's conditional approval. Under the Rule, if the debtor is a small business and has made a timely election to be considered a small business in a Chapter 11 case, the court may, on application of the plan proponent, conditionally approve a disclosure statement filed in accordance with Fed. R. Bankr. P. 3016. Fed. R. Bankr. P. 3017.1(a). Under Rule 3016, a small business debtor's disclosure statement is sufficient if it complies with 11 U.S.C. §§ 1125(f)(1)-(3).

[51] 11 U.S.C. § 1125(f)(3) (2012).

[52] 11 U.S.C. § 1125(f)(1) (2012).

[53] Prior to BAPCA, The National Bankruptcy Review Commission concluded that the drafted-from-scratch disclosure statement and plans typical in Chapter 11 practice at the time were a major contributor to the high cost of the Chapter 11 process. *See* NAT'L BANKR. REV. COMM'N, FINAL REPORT, BANKRUPTCY: THE NEXT TWENTY YEARS 53, 636-37 (1997). The Commission also predicted that the use of standard forms would increase the quality of disclosure statements and plans. The Commission determined that at that time, "[d]ebtor's counsel is often left with the choice of submitting a poorly drafted plan and a perfunctory disclosure statement, or creating legal fees greater than the debtor can bear." *Id.* at 637. In this context, "standard forms increase the likelihood that all required topics will be covered, as they are easier to use than custom-created documents." *Id.*

debtors. The freedom to file a combined disclosure statement and plan is also beneficial because it allows the debtor to streamline the confirmation process.

Strict adherence to deadlines is a notable burden imposed on small business debtors by BAPCA. For example, the 45 day post plan submittal to the court confirmation deadline means that if the debtor cannot confirm a plan within the timetable, the court may dismiss the case.[54] Another example is found in the Code's exclusivity provisions. The Code's exclusivity provisions generally "caps" the time period in which a small business debtor may file a Chapter 11 plan and disclosure statement at 300 days.[55] This period can, of course, be extended within the original 300-day period if the debtor can demonstrate that plan confirmation within a "reasonable period" is "more likely than not."[56] But as a practical matter, the debtor has about

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[54] *See* 11 U.S.C.A. § 1129(e); *see also In re* J & J Fritz Media, Ltd., 64 Collier Bankr. Cas. 2d (MB) 1488, 2010 WL 4882601 (Bankr. W.D. Tex. 2010) ("A small business case must be confirmed within 45 days after the filing of a plan"); *In re* Roots Rents, Inc., 420 B.R. 28, 52 Bankr. Ct. Dec. (CRR) 130, Bankr. L. Rep. (CCH) P 81650 (Bankr. D. Idaho 2009) (requiring denial of untimely motion to extend 45-day deadline under § 1129(e) and dismissal of Chapter 11 case); *In re* CCT Communications, Inc., 420 B.R. 160, 168, 52 Bankr. Ct. Dec. (CRR) 139 (Bankr. S.D. N.Y. 2009) (if the small business debtor fails to confirm a plan within 45 days after it was filed, cause is established under § 1112(b)(4)(J) to dismiss, and the court must dismiss or convert unless it determines that one or more of three limited exceptions exist); *In re* Caring Heart Home Health Corp., Inc., 380 B.R. 908, 910, 49 Employee Benefits Cas. (BNA) 143, Bankr. L. Rep. (CCH) P 81114 (Bankr. S.D. Fla. 2008) (statute requires denial of an untimely motion to extend the 45-day deadline under § 1129(e) and dismissal of the Chapter 11 case); *In re* Save Our Springs (S.O.S.) Alliance, Inc., 393 B.R. 452, 456, 50 Bankr. Ct. Dec. (CRR) 120, 60 Collier Bankr. Cas. 2d (MB) 395 (Bankr. W.D. Tex. 2008), aff'd, 2009 WL 8637183 (W.D. Tex. 2009), *judgment aff'd*, 632 F.3d 168, 54 Bankr. Ct. Dec. (CRR) 56, 64 Collier Bankr. Cas. 2d (MB) 1686, Bankr. L. Rep. (CCH) P 81924 (5th Cir. 2011) (failure to confirm a plan within 45 days of filing the plan constitutes "cause" within the meaning of § 1112(b)(1) to dismiss or convert a Chapter 11 case).

[55] *See* 11 U.S.C.A. § 1121(e)(2); *see also In re* Florida Coastal Airlines, Inc., 361 B.R. 286 (Bankr. S.D. Fla. 2007) (Statutory 300-day period for small business debtor to file Chapter 11 plan of reorganization was not applicable to other parties, and thus creditor was entitled to file competing reorganization plan after expiration of statutory period); *In re* Randi's, Inc., 474 B.R. 783, 56 Bankr. Ct. Dec. (CRR) 187, 67 Collier Bankr. Cas. 2d (MB) 1898 (Bankr. S.D. Ga. 2012) (few courts had considered whether the time period imposed by amended§ 1121(e)(2) applied solely to a debtor, or extended to other parties; nevertheless, once the 300-day time period ended and no plan had been filed by any party in interest, "cause" for dismissal existed under 11 U.S.C. § 1112(b)(4)(J)).

[56] *See* 11 U.S.C.A. § 1121(e)(3); *see also In re* Darby General Contracting, Inc., 410 B.R. 136, 52 Bankr. Ct. Dec. (CRR) 7, Bankr. L. Rep. (CCH) P 81590 (Bankr. E.D. N.Y. 2009) (Small business debtor was not entitled to extension of time in which to obtain confirmation of Chapter 11 plan, where debtor had not acted with diligence required in small business case, in repeatedly failing to meet or seeking extensions of deadlines, failed to demonstrate that it had made any progress in negotiations with the Internal Revenue Service or holder of state tax claim, and failed to submit evidence from which court could determine that confirmation of plan within reasonable amount of time was likely); *In re* CCT Communications, Inc., 420 B.R. 160, 52 Bankr. Ct. Dec. (CRR) 139 (Bankr. S.D. N.Y. 2009) (regardless of whether debtor was, in fact, a "small business debtor," fact that debtor, by virtue of holding itself out as small business debtor, had obtained extension of exclusivity period for filing plan to which it would not have been entitled but for its putative small business debtor status was enough to judicially estop debtor from subsequently changing course and denying its status as small business debtor); *In re* Doug Larsen Const., Inc., 56 Bankr. Ct. Dec. (CRR) 198, 68 Collier Bankr. Cas. 2d (MB) 504, 2012 WL 2562420 (Bankr. D. Idaho 2012) (debtor was precluded by 11 U.S.C. § 1121(e)(3)(C) from obtaining approval of its second motion for a time extension under § 1129(e), because the court had not signed an order granting its first motion, and because it had filed its second motion after the 45-day period the court had to confirm the plan had already expired); *In re*

10 months to get a Chapter 11 plan and disclosure statement filed. This is a troubling evolution of the Code because, historically, exclusivity rights were instrumental in the Chapter 11 bargaining process.[57] An exclusivity right gives the debtor a bargaining chip and entices creditors to the bargaining table.[58] Perhaps more troubling is the argument that imposing strict plan deadlines was, at the time, unjustified.[59] Empirical analysis of data gathered by the Business Bankruptcy Project shows that eighty two percent of "small business"[60] cases from their 2002 sample, which ultimately confirmed a plan, did so outside of the timelines imposed by BAPCA.[61] If the BAPCA timelines were extended by only 90 days, the percentage of cases from the same data sample which would make the deadline increases from eighteen percent to thirty five percent.[62] It deserves repeating that the debtors in the sample cases could not make use of BAPCA's small business provisions, were not facing looming statutory deadlines, and could have perhaps acted quicker.[63] Even before BAPCA, a large percentage of the cases which ultimately failed with no-plan exited bankruptcy before the post-BAPCA deadlines.[64] Fifty percent of those cases exited bankruptcy in less than 180 days, and seventy five percent exited by nine months.[65] Those percentages do not suggest that the majority of cases doomed to fail clogged the courts for an extended amount of time.

The cumulative effect of the BAPCA small business provisions appears to result in increased obligations for small businesses without a corresponding increase in the probability of reorganization.[66] The combination of increased reporting and compressed deadlines puts any small business case under extreme pressure due to the dismissal provisions of section 1112, also

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Mississippi Sports and Recreation, Inc., 483 B.R. 164 (Bankr. W.D. Wis. 2012) (§ 1121(e)(3) did not require the consent of creditors; it merely contemplated that all necessary parties know of the proposed action and were given an opportunity to participate).

[57] Warren, Elizabeth & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 Mich. L. Rev. 603, 639 fn. 120 (2009).

[58] *Id.*

[59] *Id*. at 638-40

[60] Warren & Westbrook offer the following justification for using pre-BAPCA date to justify the effect of the 2005 amendment "With some reasonably realistic assumptions, however, the data can be adapted to test the likely impact of the 2005 changes. If, as is widely assumed, the small cases in our sample had no active creditors committee and if they were not affiliates of corporate groups aggregating more than $2 million in debt, then the cases in the sample with less than $2 million (inflation adjusted) in assets would have fallen within the new restrictions imposed by the 2005 Amendments." *Id.* at 638-639.

[61] *Id.* at 639

[62] *Id.*

[63] *Id.*

[64] *Id.*

[65] *Id.*

[66] NAT'L BANKR. CONFERENCE, *supra* note 19.

expanded by BAPCA.[67] There are certainly benefits to small business debtors in the Code, but enjoyment of those benefits routinely hinges on a deadline. The obstacles faced by small businesses debtors after BAPCA mean that only those debtors that are well prepared and organized really stand to benefit from designation as a small business. This is unfortunate because it means that there are, in all probability, many small business cases where, because of the cost saving disclosure provisions, a small business debtor could emerge from Chapter 11 as a viable entity but are prevented from doing so by a failure to meet the stringent statutory deadlines. If the filing deadlines were extended, or removed altogether, while preserving the cost saving amendments to the disclosure provisions, perhaps more qualifying debtors could and would take advantage of the BAPCA small business provisions.

Summary re Reducing Administrative Costs and Burdensome Deadlines

History suggests that there are middle market and smaller Chapter 11 cases which would have emerged from bankruptcy intact but for administrative costs pushing the case into liquidation.[68] The ability to shorten or outright bypass (where a proposed plan is sufficient) the Code's disclosure requirements can be a valuable cost saving tool when wielded by a capable debtor. Eliminating or lengthening the constrictive timetables placed on small business debtors could further Congress's objective behind enacting BAPCA. Removing the dollar caps on electing small business treatment and making that election optional for all debtors could provide

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[67] Initially, a movant must establish cause for conversion of a small business case. *See* 11 U.S.C. § 1112(b)(1). After BAPCPA, bankruptcy courts have less discretion on the conversion or dismissal decision. *See In re* Products Intern, Co., 395 B.R. 101 (Bankr. D. Ariz. 2008) (citing *In re* AmeriCERT Inc., 360 B.R. 398, 401 (Bankr. D. N.H. 2007), and *In re Gateway Access Solutions Inc.*, 374 B.R. 556 (Bankr. M.D. Pa. 2007)). The burden then shifts to the debtor to prove the exceptions set forth in 11 U.S.C. § 1112(b)(2). The exceptions in § 1112(b)(2) may not apply if dismissal is based on loss or diminution to the estate under 11 U.S.C. § 1112(b)(4)(A). 11 U.S.C. § 1112(b)(1). Dismissal under any other clauses of § 1112(b)(4) requires consideration of the "unusual circumstances." Prior to reviewing unusual circumstances, a court must consider whether there is a reasonable likelihood of confirmation within the times set out in 11 U.S.C. §§ 1121(e) and 1129(e). *See* 11 U.S.C. § 1112(b)(2)(A). If a debtor cannot comply with the time periods, a court should dismiss the bankruptcy case. *In re* Dovetail Inc., No. 07–B–72820, 2008 WL 5644889, at *1 (Bankr. N.D. Ill. Dec. 31, 2008). If time is not an issue, a debtor must show that any act or omission that is cause to convert or dismiss the chapter 11 case has a reasonable justification that the debtor could cure within a reasonable period of time. 11 U.S.C. § 1112(b)(2)(A). If the answer to these questions is "yes," the court must then identify unusual circumstances to avoid conversion or dismissal. "Unusual circumstances" are not defined by the Bankruptcy Code, but the existence of "unusual circumstances" necessarily contemplates conditions that are not common in chapter 11 cases. *See In re* Kent, No. 2:07–bk–03238–SSC., 2008 WL 5047799, at *5, n.5 (Bankr. D. Ariz. Sept. 23, 2008); *In re* Fisher, No. 07–61338–11., 2008 WL 1775123, at *6 (Bankr. D. Mont. April 15, 2008). Further, proving unusual circumstances does not require proof that is "extraordinary and compelling." *In re* Melendez Concrete Inc., No. 11–09–12334 JA., 2009 WL 2997920, at *6 (Bankr. D. N.M. 2009). As the *Melendez Concrete* court explained: "When Congress enacted [BAPCPA], it used the phrase 'absent unusual circumstances' in 11 U.S.C. § 1112(b)(1), while using the different phrase 'absent extraordinary and compelling circumstances' in the newly enacted 11 U.S.C. § 1116. The court need not find that the circumstances are 'extraordinary and compelling' to find that they are 'unusual.'" *Id.*

[68] Warren & Westbrook, *supra* note 57, at 636 ("The data presented here are consistent with the hypothesis that the costs of Chapter 11 are sufficiently high that many small companies were squeezed out of the system, forcing the managers to liquidate the business quickly in Chapter 7 or die quietly completely outside the bankruptcy system.").

debtors who would otherwise re-organize absent prohibitive administrative costs a much higher chance of achieving that objective.[69]

## II. Uniform Procedure for Section 363 Sales of Substantially All the Assets of a Business

### A. Introduction to Section 363 Sales

In contrast to sales made under a chapter 11 plan, transfers of assets made under § 363 (Use, Sale, Lease of Property) require no more process or court supervision than notice and a hearing,[70] making this route of reorganization much faster than the traditional confirmation process. No disclosure statement is required,[71] nor must the notice or the sale motion itself contain all of the information that a plan must contain under § 1123 (Contents of Plan) or that a disclosure statement must contain under § 1125 (Postpetition disclosure and solicitation).[72] Additionally, the sale proponent need not obtain the super-majority consent of each class of creditors and interest holders.[73] In sum, a debtor may essentially sell its entire business under § 363(f) with no more than a simple motion, notice, and a hearing--although in most business cases, at least two hearings are common, one to announce the stalking horse bidder and establish overbid procedures and another to confirm the sale to the winning bidder. Even with two hearings, however, this process is a far cry from the extensive disclosure and acceptance processes required in a traditional plan confirmation setting. The validity of an asset sale to a bona-fide-purchaser is unaffected by the appeal of the sale order unless the objecting party

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[69] Businesses on the upper end of the middle market may gain the greatest benefit. Larger businesses share several characteristics which suggest they are more capable of surviving Chapter 11. Those characteristics include bigger war chests to withstand the disruptions in supplies and other economic bumps that accompany a bankruptcy filing, a higher level of sophistication when considering a Chapter 11 alternative, and less reluctance in heading to Chapter 11, before the business has completely collapsed. Warren & Westbrook, *supra* note 57, at 637. Workout professionals are more likely to help big businesses, and they may be especially willing to recommend bankruptcy. *Id*. Whatever the reasons, it is clear that bigger companies file for Chapter 11 in higher numbers and, once they have arrived, they fare better within Chapter 11. *Id*. Size also affects speed. *Id*. (footnote omitted). Larger companies may have had to resolve difficulties imposed by more complex operations and have had more creditors to negotiate with. *Id.* On the other hand, these larger companies may also enjoy the benefits of resources to hire expert lawyers, accountants, and other professionals. *Id.*

[70] *See* 11 U.S.C. § 363; *see also* George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 Am. Bankr. L.J. 235, 239 n.17 (2002) ("Misinterpreting I") (noting a sale under § 363(f) may occur without an actual hearing). "Absent an objection, and assuming that the pleadings provide an evidentiary basis to support the sale, there is not even the need for a hearing." *Id.* at 239 n.17 (citing 11 U.S.C. § 102(1) (defining "after notice and a hearing" as including situations where the bankruptcy court issues an order after proper notice, but where no hearing has occurred because no party requested one or where there was no time to hold a hearing)). Note also that a sale under § 363(f) must only satisfy one of the five statutory requirements for the court to approve it. *See* 11 U.S.C. § 363(f) (using the word "or" to connect the last element of its listed requirements). In contrast, confirmation requires the debtor-transferor to satisfy multiple requirements before approval. *See generally* 11 U.S.C. §§ 1121-1129.

[71] *See* John J. Hurley, *Chapter 11 Alternative: Section 363 Sale of All of the Debtor's Assets Outside a Plan of Reorganization*, 58 Am. Bankr. L.J. 233, 235 (1984).

[72] *See Id.* at 235

[73] *See* 11 U.S.C. § 1125.

obtains a stay.[74] An order approving the sale is stayed for 14 days after the order, unless the court orders otherwise, which it is not uncommon upon request by an interested party.[75]

B. The Arguments for Section 363 Sales

By selling all of the debtor's business or businesses preconfirmation under 363, these parties may avoid the lengthy process of negotiating, proposing, confirming, and consummating a plan of re-organization – not to mention the potential for more pervasive scrutiny of transactions at multiple junctures by the court, creditors, the United State Trustee, and other parties of interest.[76] Assets may be transferred from the debtor's estate free and clear of both interests and claims, perhaps enhancing their marketability.[77] All or some of these benefits can thus be obtained without having to satisfy the requirements for plan acceptance contained in sections 1121-29.[78]

Because both a confirmed plan of reorganization and a non-plan sale of substantially all the debtor's assets garner going concern value (at least theoretically), the least expensive and time-consuming of the two processes is preferable, assuming that the process in question is appropriately transparent, features adequate exposure of the assets to the market, and allows parties in interest to examine the transaction and voice their support or objections in a meaningful way.[79] Rather than involving the bankruptcy court in the difficult process of valuing a business, evaluating a business plan, and generally speculating on the future of the enterprise based on the briefs and arguments of attorneys and the reports of hired-gun professional experts, the non-plan sale process allows the court to concentrate on tasks for which it is well suited, process and procedure.[80] The non-plan sale route capitalizes on one of the most powerful reorganization techniques in the Chapter 11 scheme: separating assets from liabilities.[81]

A non-plan sale completes the separation of the assets from the liabilities much sooner and in a more complete fashion than a traditional plan of reorganization, replacing the assets with their proceeds and allowing a business--but not the debtor, its former owner--to emerge from the bankruptcy estate and escape the negative effects of the administrative expense, uncertainty, and

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[74] 11 U.S.C. § 262(m) (2012).

[75] 11 U.S.C. § 6004(h) (2012).

[76] George W. Kuney, *Hijacking Chapter 11*, 21 Emory Bankr. Dev. J. 19, 105 (2005) ("Hijacking").

[77] *Id.* at 105-06

[78] *Id.* at 106

[79] George W. Kuney, *Let's Make It Official: Adding an Explicit Pre-Plan Sale Process as an Alternative Exit from Chapter 11*, 40 Houston L. Rev. 1265, 1282-84 (2004).

[80] *Id.* at 1284

[81] *Id.* at 1271-72

stigma that is attendant upon doing business as a debtor.[82] That accomplished, the creditors and interest holders can then sort out their relative claims to the proceeds and the means by which value will be divided and distributed among them.[83] By compartmentalizing these reorganization functions into two stages-- asset redeployment and, later, distributional categorization/treatment--the reorganization process is made more efficient: operating assets are returned to the non-bankruptcy world with lower transaction costs than under the reorganization-by-plan scenario.[84]

By selling the assets of a business as a unit, rather than in a piecemeal liquidation, going concern value can be captured for the benefit of the estate.[85] By reducing the assets of the estate to cash, a note secured by the assets sold, the stock of the purchaser, or some other similar form of fungible valuable consideration, the tasks and costs of post-sale management and administration of a debtor and its estate can be dramatically reduced.[86] This allows for a reduction in the amount of a debtor's value that is redistributed from prepetition creditors to post-petition administrative claimants as a case drags on. It takes little in the way of a management team to preside over an estate comprised solely of liquid assets.[87] Further, once reduced to liquid assets, proposal and confirmation of a strict or absolute priority plan or conversion of the case to one under Chapter 7 should lead to speedy distributions to creditors and a minimum of haggling and litigation over proper priorities.[88] All told, there is very little in the way of reorganization that cannot be accomplished through a sale.[89]

### C. Criticisms of 363 Sales

The broad interpretation of the word “interest” in § 363(f) to include “claims” provides extraordinary benefits to DIP lenders, prepetition secured creditors, purchasers of assets in § 363(f) sales, and insiders to the detriment of voluntary general unsecured creditors and involuntary creditors such as tort claimants. These free and clear sales allow the debtor to attract the interest of potential purchasers that might not otherwise be interested in the transaction or, if they would have been, to command a higher purchase price.

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[82] *Id*. at 1273

[83] *Id.*

[84] *Id.*

[85] Kuney, *supra* note 79, at 1270

[86] *Id.* at 1270-71

[87] *Id*. at 1271

[88] *Id.* at 1271-72

[89] *Id*. at 1286

Often, DIP lenders will condition their loans on a quick sale.[90] Likewise, prepetition secured creditors (who often serve as the DIP lenders) may restrict the debtor's use of its cash collateral unless a reorganization-by-sale program is adopted.[91] Both of these actions result in inducing--or even forcing--the debtor to sell all or substantially all of its assets as a going concern via a fast § 363(f) sale.[92] These lenders benefit from this result by realizing on their interests[93] more quickly by avoiding a lengthy confirmation process and controlling the process so as to avoid further risk. Furthermore, because the business is transferred as a going concern, lenders have the opportunity to extend new lines of credit to the purchasers, who are presumably in a better financial position than the debtor.[94]

Purchasers receive probably the most tangible benefits from the broad interpretation of § 363(f).[95] These parties are able to acquire entire businesses unencumbered by unsecured debts, successor liability, or property interests.[96] Likewise, insiders may benefit from these sales, especially when the majority of their postpetition compensation is tied to the sale of the corporation or where they expect to be employed by the purchaser post sale.[97] These benefits,

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[90] Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 Stan. L. Rev. 751, 785 (2002).

[91] *Id.* at 784

[92] *See, e.g., In re* Qualitech Steel Corp., 276 F.3d 245 (7th Cir. 2001).

[93] Under § 363(f) (3), the sale must be for more than the aggregate value of all liens on the assets. Thus, DIP lenders and secured creditors likely face little risk of losing the value of their interests in a § 363(f) sale, while unsecured creditors and other parties in interest have little to no protection. Furthermore, because courts often hold that § 363(f) transfers property free and clear of both claims and interests, buyers are not too difficult to locate, speeding up the process. *See* Baird & Rasmussen, *supra* note 90, at 786.

[94] As one practitioner observed in a conversation with the author: "The buyer doesn't care about 363(f) distortions because the secured creditor is the guy pushing the debtor to do this sale. The secured creditor is actually going to finance the buyer. In these 363 sales pushed through within the first 90 days of the case (or later), it is very seldom the secured creditor who is objecting.

[95] *See* Steve E. Fox & Adam H. Friedman, *Is the Safe Harbor Afforded by 363(f) Not So Safe Anymore?*, 16 No. 12 Bankr. Strategist 1 (1999); John J. Hurley, *Chapter 11 Alternative: Section 363 Sale of All of the Debtor's Assets Outside a Plan of Reorganization*, 58 Am. Bankr. L.J. 233, 248 (1984). Indeed, one advantage to purchasers--at least those within the jurisdiction of the Third Circuit--may be that they will be able to buy assets free and clear even in the absence of a cognizable interest in property. *See In re* Trans World Airlines, Inc., 322 F.3d 283, 291 (3d Cir. 2003). ("Even were we to conclude that the claims at issue are not interests in property, the priority scheme of the Bankruptcy Code supports the transfer of TWA's assets free and clear of the claims.").

[96] *See* Guidelines for Financing Requests: United States Bankruptcy Court for the Southern District of New York, Int'l Insolvency Inst. at 8 (Mar. 20, 2002) ("Waivers: Extraordinary Provisions are those that divest the Court of its power or discretion in a material way, or interfere with the exercise of the fiduciary duties of the debtor or Creditors' Committee in connection with the operation of the business, administration of the estate, or the formation of a reorganization plan ...."). *But see* Charles Jordan Tabb, *Emergency Preferential Orders in Bankruptcy Reorganizations*, 65 Am. Bankr. L.J. 75, 87,89 (1990).

[97] 11 U.S.C. § 726(b) (2012); Peter Antoszyk, *Trends in Debtor in Possession Financing*, *1, *3 (2001) (discussing the financing options and procedures for debtors-in-possession) at http://abiworld.org/abidata/online/conference/01wlc/Antoszyk.html.

however, may be realized at the expense of the unsecured creditors and other parties in interest, who can do little more than object to a § 363(f) sale.[98]

Before embracing or condemning this trend, one must determine whose ox, if anyone's, is being gored by the practice.[99] The principal stakeholders[100] involved are easily categorized. First are those with a legally cognizable direct claim against or interest in the debtor or its assets: secured creditors,[101] administrative priority creditors,[102] other priority creditors,[103] general unsecured creditors,[104] landlord creditors,[105] employees with long-term employment contracts or

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[98] *See* Antoszyk, *supra* note 97, at *11; *see also In re* Blanton Smith Corp., 81 B.R. 440, 444 (Bankr. N.D. Ill. 1987). In *Blanton*, the court held "an order confirming a chapter 11 plan was res judicata, and the provisions granting security interests to administrative claimants were not subject to reconsideration by the court upon conversion to chapter 7." 81 B.R. at 445.

[99] *Cf.* Adarand Constructors, Inc. v. Pena, 515 U.S. 200, 241 (1995) (discussing classification of racial discrimination as "benign" or "malign" and finding the distinction depends on one's perspective: whose ox is being gored or whose "eye" is that of the "beholder"); *see also* C.R. Bowles & John Egan, *The Sale of the Century or a Fraud on Creditors?: The Fiduciary Duty of Trustees and Debtors in Possession Relating to the "Sale" of the Debtors' Assets in Bankruptcy*, 28 U. Mem. L. Rev. 781 (1998) (examining impacts of mechanics of § 363 sales upon debtors' fiduciary duties and urging limits on use of control incentives, adoption of a benefit to the estate test for stalking horse protections, and giving bona fide bidders standing to object to and appeal § 363 motions and orders).

[100] *See* Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. Ill. L. Rev. 503, 519 (it is not enough to examine bankruptcy law from a perspective of creditor welfare; all parties affected by the debtor's financial distress should be considered in the analysis); *see generally* The Corporate Stakeholder Conference, 43 U. Toronto L.J. 29-798 (1993) (series of articles examining various stakeholder constituencies of artificial business entities).

[101] Secured creditors are those that hold a security interest or lien on the debtor's property. 11 U.S.C. § 506(a). They are oversecured if they hold a lien or security interest that, because of its priority or the value of the collateral, is sufficient to ensure payment through foreclosure of the full balance of their claim, in which case they may be entitled to postpetition interest, attorneys' fees, and other costs and charges. 11 U.S.C. § 506(b); United States v. Ron Pair Enter., Inc., 489 U.S. 235 (1989) (involuntary oversecured creditors entitled to interest; voluntary oversecured creditors entitled to interest and reasonable fees, costs, and expenses provided for in their agreements). Undersecured creditors are those whose lien or security interest, because of priority or the value of the collateral, is insufficient to ensure payment of their full claim; they hold two claims, one secured up to the value of their lien and the other an unsecured deficiency claim that, generally, is classified with those of the general unsecured creditors. 11 U.S.C. § 506(a), (d).

[102] Administrative priority creditors are those with claims for administrative expenses under § 503(b) and United States Trustee fees under Chapter 123 of title 28. 11 U.S.C. § 507(a) (1). Section 503(b) administrative expenses include the postpetition actual, necessary costs and expenses of preserving the estate, including allowed fees of professionals such as attorneys and accountants, certain taxes and fines, and certain creditor or indenture trustee expenses that result in a benefit to the estate. 11 U.S.C. § 503(b).

[103] Other priority unsecured creditors include limited claims for employee wages and commissions, contributions to employee benefit plans, amounts owing to grain producers and fishermen, customer deposits for goods or services, interspousal debts such as alimony and support, additional categories of tax claims, and FDIC claims. 11 U.S.C. § 507(a) (2)-(9).

[104] General unsecured creditors are a residual class. See 11 U.S.C. § 726(a) (2)-(5). They are not separately defined by the Code. They include all those that are not secured creditors, priority unsecured creditors or equity holders. They include landlord creditors and long term employment contract creditors, to the extent that they are unsecured,

collective bargaining agreements,[106] and equity stakeholders.[107] Second are those members of society who lack such a direct legal claim or interest in the debtor or its property, but who are nevertheless also directly affected by the transaction: the debtor's employees, suppliers, and customers; the surrounding community; and the public at large and its confidence in the judicial system.[108]

### 1. Secured Creditors

Secured creditors are little harmed by the fast-track sale approach, arguably even benefitting from it.[109] Indeed, as a practical matter, large secured creditors are often instrumental in coordinating the sale, and often consent to and support it going forward with all possible

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although in this discussion those subgroups are broken out separately because of statutory maximums imposed upon their claims.

[105] Landlord creditors are general unsecured creditors to the extent that they are not secured creditors by reason of a security deposit that they hold. See generally Michael St. James, *Landlord Beware*: *Will a Security Deposit Survive a Bankruptcy?*, 26 Cal. Bankr. J. 44 (2001) (exploring scope of appropriate application of security deposit and potential for refund of same to the estate under California law). Because landlord claims for breach of a long-term lease of real property may be massive in comparison to the claims of other unsecured creditors, and because of the potential for mitigation of their future damages through re-letting of the premises involved, the Code imposes a statutory maximum on these claims. 11 U.S.C. § 502(b)(6) (limiting claims for breach of lease to the greater of the rent for one year or fifteen percent of the remaining term of the lease, plus unpaid prepetition rent).

[106] Like landlords, employees with long-term employment contracts are subject to a statutory maximum on their claims because of the potential size of the claims, the potential for mitigation of future damages, and the equity holder-like relationship of those with truly long term employment contracts. 11 U.S.C. § 502(b) (7) (2000) (limiting such claims to one year's compensation plus unpaid prepetition compensation).

[107] Although the Code treats equity holders as being “interest holders,” see, e.g., § 1129(b) (2) (C) (using the term for the lowest rung on the priority ladder for absolute priority rule purposes), it nowhere defines “interest.” *See also* 11 U.S.C. § 101(17) (2000) (“equity security holder” means one holding an “equity security”); 11 U.S.C. § 101(16) (2000) (“equity security” means corporate shares and similar securities, limited partnership interests, or warrants or rights to purchase these items). The Code has not quite caught up to limited liability company (LLC) practice and does not define or take into account LLCs, their members or membership interests. Yet LLCs are not excluded from being debtors. *See* 11 U.S.C. § 109 (2000). In all probability, courts faced with the issue will recognize membership interests as equity interests by analogy to the existing classifications of § 101(16).

[108] *See* WILLIAM M. EVAN & R. EDWARD FREEMAN, A STAKEHOLDER THEORY OF THE MODERN CORPORATION: KANTIAN CAPITALISM, ETHICAL THEORY & BUSINESS 97, 101-05 (Tom L. Beauchamp & Norman E. Bowie eds., 3d ed. 1988) (arguing that the typical focus on corporate duties to “shareholders” should be shared with other “stakeholders” such as employees, suppliers, local communities and perhaps many others). The shift in the focus from shareholder to stakeholder is demonstrated by passage of statutory “corporate constituency statutes” by over half of the states in the union. Timothy L. Fort, *The Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and Corporate Constituency Statutes*, 73 Notre Dame L. Rev. 173, 174 (1997). These statutes generally allow, but do not require, managers to take into account nonshareholder constituencies in making corporate decisions. *Id. See also* Richard M. Cieri et al., *Breaking Up Is Hard To Do: Avoiding the Solvency-Related Pitfalls in Spinoff Transactions*, 54 Bus. Law. 533, n.31 (1999) (discussing constituency statutes and collecting same).

[109] *See* Kuney, *supra* note 76.

speed.[110] Even smaller secured creditors routinely consent to a sale after assuring that the value of their collateral is reflected in the purchase price and that they will be entitled to their fair share of the proceeds. Both large and small secured creditors save costs associated with foreclosing on their collateral by, instead, having it gathered, managed, and sold by those who are the most familiar with it: the personnel of the debtor in possession. Further, the going-concern value of the collateral is likely to be higher than its piecemeal liquidation value, and that value may be further enhanced by the protection from successor liability to be enjoyed by the purchaser. The bankruptcy sale transaction also benefits secured creditors by reducing collateral and noncollateral to proceeds of collateral in which a secured party has a direct interest.[111] As a result, in a § 363 sale the secured creditor can, in some instances, effectively gain a security interest in noncollateral that is sold, something it could not gain through state-law foreclosure.[112] Finally, because secured creditors maintain their secured status either through possession of the collateral or a filing with the appropriate state or federal office, their interests are of record and they generally will receive prompt notice of the proposed sale so that they can easily and effectively appear and protect their interests.

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[110] *See Id.* Some would argue that the preplan and plan sale cases of large corporations in Delaware's accommodating bankruptcy courts is a demonstration of how the Code's sale provisions have allowed bankruptcy proceedings to be dominated by secured creditors, insiders, and their counsel. It is common in these cases for the debtor to lack any substantial equity in its assets, and for the case to be commenced or continued largely to facilitate DIP-lending assisted improvement of secured creditors' position and a sale of the secured creditors' collateral as a going concern to avoid the need for state law piecemeal foreclosure proceedings. In exchange for cooperation with this process, the secured lenders allow the corporate insiders to retain their positions and salaries presale, obtain self-serving findings designed to insulate them from creditor and shareholder liability apart from insurance coverage, receive releases of all liability connected to the debtor and the case, and the opportunity to seek continued employment with the eventual purchaser. Sometimes unsecured creditors receive a pittance distribution that they would not receive in a state law foreclosure context, after the creditors' committee and its counsel are paid in full. Despite the recognition in many districts that it is an unwise use of federal resources to administer a case and conduct a sales effort solely for the benefit of secured creditors. *C.f.* U.S. Trustee Manual § 3-2.8.3.3 (October 1998), http://www.justice.gov/ust/eo/ust_org/ustp_manual/docs/vol3.pdf (the United States Trustee should be principally concerned with preserving the rights of the unsecured creditor), the practice is widespread.

[111] Under Article 9 of the U.C.C., a secured party can perfect a security interest on proceeds of property on which it cannot hold perfected security interest. U.C.C. § 9-408 (1999).

[112] An example may make this clear. Assume a television and radio station with an FCC license is financially troubled. Its assets are all subject to a blanket security interest in favor of a bank—"all," that is, but the FCC license, in which the bank cannot take a security interest. *See* 47 U.S.C.A. § 310(d) (2000) (license ownership restrictions); *In re* Merkley, 94 F.C.C.2d 829, 830 (1983) ("The Commission has consistently held that a broadcast license, as distinguished from the station's plant or physical assets, is not an owned asset or vested property interest so as to be subject to mortgage, lien, pledge, attachment, seizure, or similar property right."); *In re* D.H. Overmyer Telecasting Co. Inc., 35 B.R. 400, 401 (Bankr. N.D. Ohio 1983) ("The FCC retains continuing jurisdiction over Telecasting's license, despite the Chapter 11 proceeding"). When the station defaults, the bank cannot foreclose on the license, arguably the station's most valuable asset, as it is not its collateral. Outside of bankruptcy, the bank forecloses on all other property, the license is unused for the prescribed time and it is canceled by the FCC, resulting in no value for the secured creditor. In bankruptcy, in contrast, the bank helps the trustee sell the license (with appropriate FCC consents) and obtains a security interest in the proceeds, essentially reaping a windfall diminished only by the need to provide the trustee and counsel with a carve-out to cover their fees to induce cooperation. *See* QUEENAN § 20.19 CHAPTER 11 THEORY AND PRACTICE, SALES OF REGULATED PROPERTY, LICENSES & PERMITS ("the debtor in possession [of FCC licenses] must receive FCC approval of a proposed assignee of a broadcast license").

2. Administrative Priority Creditors

Administrative priority creditors are probably also benefitted by the fast-track process. The dominant players in this category are the United States trustee and the postpetition professionals, including the debtor's lawyers and accountants, the unsecured creditors' committee's lawyers and accountants, and the investment bankers and other brokers engaged as part of the case.[113] First, all these groups are intimately involved in the case and can be sure to receive both formal and informal notice of any potential sale. That allows them to seek full disclosure of all aspects of the transaction, negotiate carve-outs or other provisions that will designate some of the proceeds to be applied to their allowed claims for fees and costs, and enjoy inexpensive access to knowledge about the inside details and dynamics of the proposed transaction.

Second, and quite important, serving as a professional in a preplan sale case limits exposure to loss over that which can be sustained in a Chapter 11 case in which the debtor is struggling to emerge from Chapter 11 under a confirmed plan of reorganization. Especially if the sale is negotiated and documented prepetition, the professionals should know within thirty to ninety days of the petition date whether or not the sale is likely to gain court approval and be consummated. This stands in marked contrast to the plan confirmation strategy where plan confirmation can take years to achieve. Both through securing a prepetition retainer large enough to cover fees for one calendar quarter, and by monitoring and assessing how likely consummation of the sale is progressing, the professionals can protect their interests. The one negative effect for administrative priority claimants is that they lose the right to veto a transaction unless it provides for payment in full of their allowed administrative claims, which they enjoy in the plan confirmation process.[114] On balance, though, the preplan sale process appears to benefit administrative claimants.

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[113] 11 U.S.C. §§ 327-331 (2000) (employment and compensation of professionals and officers).

[114] 11 U.S.C. § 1129(a)(9) (2000). This is a powerful protection and source of leverage for administrative priority creditors that is only available in the confirmation process. *See* QUEENAN § 22.01 CHAPTER 11 THEORY AND PRACTICE 22:3 (“In Chapter 11 cases, the very success of the reorganization may depend on the nature and amount of priority claims. This is especially true with respect to administrative expense claims (§ 507(a)(1)) and the claims of so-called gap creditors in an involuntary bankruptcy case (§ 507(a)(2)). 11 U.S.C. § 507(a) (2000). These claims must be paid in full as a condition of confirmation of a plan of reorganization. If administrative expense claims are too great, confirmation (and therefore reorganization) may not be possible.”). For the debtors' and committees' attorneys, it may present an ethical dilemma: insisting upon full payment on the effective date of the plan may undermine or make impossible one's clients' reorganization or recovery. *See* MODEL RULES OF PROF'L CONDUCT R. 1.3 (“A lawyer shall act with reasonable diligence and promptness in representing a client.”); *see also* MODEL CODE OF PROF'L RESPONSIBILITY DR 7-101(A)(1) (“A lawyer shall not intentionally fail to seek the lawful objectives of his client.”); MODEL CODE OF PROF'L RESPONSIBILITY DR 7-101(A)(3) (“A lawyer shall not intentionally ... [p]rejudice or damage his client during the course of the relationship”). In practice the issue is most often resolved by negotiation.

3. Other Priority Creditors

To the extent that other priority creditors are affected by the increase in preplan sales, it is hard to say whether that effect is positive or negative. On the positive side, they benefit from the speed of the case, which minimizes administrative priority claims that are senior to them, and they benefit from whatever price enhancement is generated from the free and clear nature of the sale.[115] On the negative side, like administrative claimants, priority creditors lose the veto power that they enjoy over a plan of reorganization if their claims are not provided for as specified in § 1129(a) (9).[116] Because these creditors are lower in priority than administrative priority creditors, the impact of this lost veto is greater because it further decreases their already meager negotiating power. In the end and on balance, due to low payouts on account of unsecured claims, the increased use of preplan sales transactions is mostly neutral in the case of the less-than-administrative priority creditors.

4. General Unsecured Creditors, Landlord Creditors, and Employees with Long-Term Employment Contracts or Collective Bargaining Agreements

Below the level of priority creditors, it is harder to assess with any degree of accuracy the impact of preplan sale procedures on distributions. On balance, however, it is probably negative, although, as with priority creditors, the speed of the case should help control administrative claims, thus benefitting unsecured creditors. First, distributions to these lower priority creditors are often extremely low in Chapter 11 cases. This is so because secured creditors often use blanket liens to capture the value of all assets at the inception of prepetition financing or the extension of debtor in possession financing, and business entities have many different judgment-proofing strategies to employ to channel profits and value to the equity holders and insiders.[117]

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[115] Basil H. Mattingly, *Sale of Property of the Estate Free and Clear of Restrictions and Covenants in Bankruptcy*, 4 Am. Bankr. Inst. L. Rev. 431 (1996) (asserting that stripping property free and clear of interests increases value).

[116] Section 1129(a)(9) provides in pertinent part that, as a requirement for confirmation:
Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that-

> (A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;
> (B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5), 507(a) 6), or 507(a)(7) of this title, each holder of a claim of such class will receive-
>> (i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>> (ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and
>
> (C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.
> 11 U.S.C. § 1129(a) (2000).

Theoretically, any process that decreases higher priority claims and expenses would benefit these classes, but empirical evidence has yet to be gathered showing any significant benefit.[118]

The increase in preplan sales would appear to negatively impact the ability of these low priority creditors to meaningfully participate in the proceedings and look after their interests, to the extent they are so inclined.[119] When a debtor's business is sold preplan, these creditors lose the specific protections of § 1129, including the best-interests-of-creditors test,[120] the requirement that there be at least one consenting impaired class,[121] and the absolute priority rule.[122] Employees with collective bargaining agreements lose the protections specifically enacted for them in general, and retirees lose the protections enacted for their benefit and specifically included in the plan confirmation process.[123] Although creditors' committees and

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[117] Lynn M. LoPucki, *The Essential Structure of Judgment Proofing,* 51 Stan. L. Rev. 147 (1998) (describing judgment proofing techniques including leases, secured lending instruments, sale agreements, franchise agreements, licenses, and the formation of operating subsidiaries).

[118] *See* Kuney, *supra* note 70.

[119] Lynn M. LoPucki, *The Debtor in Full Control-Systems Failure Under Chapter 11 of the Bankruptcy Code?,* 57 Am. Bankr. L.J. 247 (1983) (creditors take little interest in bankruptcy proceedings only because bankruptcy legislation has failed to provide the means for them to exercise meaningful control or to make their participation profitable).

[120] 11 U.S.C. § 1129(a)(7) (2000) (a confirmable plan must provide that every creditor either accepts the plan or will receive at least as much as he would in a hypothetical liquidation).

[121] 11 U.S.C. § 1129(a)(10) (2000). Because this element is not present in the preplan sale process, theoretically the debtor could proceed to sale with no support from any class of creditors. Although unlikely in practice, this is a dramatic difference from the plan process.

[122] 11 U.S.C. § 1129(b)(2) (2000).

[123] 11 U.S.C. § 1129(a)(13) (2000) (confirmation requirement that retiree benefits be maintained at levels prescribed by § 1114). It is interesting that Congress has not chosen to specifically include compliance with § 1113, pertaining to the process for rejecting collective bargaining agreements, in § 1129(a)'s list of conditions to confirmation. The section may be incorporated by indirect reference through § 1129(a)(1)'s requirement that the plan comply with "applicable provisions of [title 11]") — although the existence of § 1129(a)(13) incorporating § 1114 into the confirmation process argues against that result. In a recent case involving construction of an already approved asset sale, the court determined that the purchaser was bound by the terms of certain collective bargaining agreements — but only because they were part of the group of contracts assumed by the purchaser under the terms of its own purchase agreement. Tenet HealthSystem Philadelphia, Inc. v. Nat'l Union of Hosp. & Health Care Employees (*In re* Allegheny Health Educ. & Research Found.), 265 B.R. 88 (Bankr. W.D. Penn. 2001). In the face of the plain assumption language, the court refused to allow a general reference in its order and in the purchase agreement to the effect that the assets were acquired free and clear of all encumbrances to defeat the principle that contracts are assumed in toto or not at all. *Id.* at 101-05; 11 U.S.C. § 1114 (2000) (payment of insurance benefits to retired employees). But this does not mean that sales of substantially all assets are, per se, subject to collective bargaining agreements; just the opposite is true. United Food & Comm. Workers Union v. Family Snacks, Inc. (*In re* Family Snacks, Inc.), 257 B.R. 884 (B.A.P. 8th Cir. 2001) (court upholds rejection of collective bargaining agreement on theory that it was no longer needed for an effective reorganization after sale of substantially all of the debtor's assets and when the debtor was no longer a going concern). Debtors and purchasers will run afoul of §§ 1113 and 1114, if at all, only when they include conditions for modifications and waivers of those obligations in an asset purchase agreement that provides for their assumption. *See, e.g.,* Am. Flint Glass Workers Union v. Anchor Resolution Corp., 197 F.3d 76 (3d Cir. 1999). In any event, notwithstanding §§ 1113 and 1114, it would appear that employees and

their counsel ensure some protections, the speed at which preplan sales proceed certainly makes it less likely that individual creditors will be able to meaningfully participate. Further, special interest groups, such as landlords and employees with long-term employment contracts generally have no committee to address their special needs and interests.[124] On balance, it is hard to see how speeding up the reorganization case increases the negotiating leverage of these creditors or provides anything but a decrease in the flow and quality of information they receive and the ability to protect their particular interests. Absent a strong showing that the values received by the estate will be enhanced sufficiently to meaningfully increase dividends to general unsecured creditors, there is nothing to outweigh those negatives.

5. Equity Stakeholders

Equity holders can generally be divided into three categories: insiders,[125] majority interest-holders, and minority interest-holders. There may be overlaps between these categories. Preplan sales favor these groups in the order listed when compared to the full process for proposal, solicitation, and confirmation of a reorganization plan. Again, speeding up the case and minimizing the formal disclosure that must take place, the opportunities to challenge or test the information disclosed, and the time to negotiate the terms of the deal benefits those who are on the inside of the deal and those with large stakes and correspondingly large leverage at the expense of less knowledgeable, smaller interests.[126]

6. Employees

To the extent that they are not priority or general unsecured creditors or equity security holders, employee self-interest lies in the promise of future employment on similar or better terms. The sale free and clear does nothing to advance these interests. Just the opposite, by allowing sales free and clear of employee successor-liability claims that would lie under applicable non-bankruptcy law as well as free and clear of collective bargaining agreements, the sale free and clear decreases the leverage that employees would otherwise enjoy by using

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retirees may be stripped of their benefits under their collective bargaining agreements and retirement plans if the business is sold as a collection of assets under § 363(b) and (f), unless the affected parties and the court are vigilant. *See, e.g.*, *In re* Condere Corp., 228 B.R. 615 (Bankr. S.D. Miss. 1998) (court states that any objections by a union to an asset sale can be satisfied by conditioning the sale on the assumption by the debtor of the collective bargaining agreement and assignment of that agreement to the purchaser).

[124] *But see* 11 U.S.C. § 1114(d) (2000) (upon motion bankruptcy court shall appoint a committee of retired employees if the debtor seeks to modify or cancel retiree benefits).

[125] 11 U.S.C § 101(31) (2000) (definition of insider).

[126] This is not a new phenomenon. In 1940 the Securities and Exchange Commission, under the leadership of Justice-to-be William O. Douglas, finished three years of study and concluded that public investors need protection from insiders in reorganization cases. Tabb, *supra* note 96, at 30 n.216 (citing S.E.C., Report on the Study and Investigation of the Work, Activities, Personal Function of Protective and Reorganization Committees, pts. 1-8 (1937-1940)).

successor-liability claims as a point of leverage.[127]

Although many Chapter 11 reorganization cases are heralded into court at their inception with carefully-worded professions of business revitalization and job preservation after working through whatever event precipitated the bankruptcy filing, in many sale cases these announcements are made to keep the employees at their jobs, thereby preserving the going-concern value pending approval of the sale. Many purchasers also desire that the employees stay on immediately after the closing to manage the transition to new ownership. Once new management is in place, especially when the purchaser is in the same business as the debtor/seller, the workforce is often “downsized” to eliminate duplicate positions.

7. Suppliers and Customers

Similarly, suppliers' and customers' interests are, at best, not advanced significantly by the preplan sale procedure. As with employees, after the case is commenced, suppliers and customers are to be mollified and kept satisfied so that the going-concern value of the business can be preserved. In the case of purchase by one of the debtor's prepetition competitors, postclosing, suppliers can expect to face increased competition and customers can expect to face decreased competition, neither of which is to their benefit. Further, to the extent that suppliers enjoy favorable contracts with the debtor/seller, the buyer will not be motivated to purchase or to take these contracts by assumption and assignment. The truncated preplan sale procedure minimizes the time in which the suppliers can enjoy the benefits of their preexisting contracts.

8. The Surrounding Community and the Public

Any process that increases the speed of change in the rights and duties of various parties has the potential to decrease the meaningful participation of slow-moving bureaucracies and smaller, unrepresented portions of the community. This being the case, the preplan sale procedure holds the potential for decreased input from these groups as compared to the plan confirmation process. With the exception of governmental actors, this difference is probably minimal, since members of the public usually do not have standing to appear and be heard in the

[127] *In re* Lady H Coal Co., Inc., 193 B.R. 233 (Bankr. S.D. W.Va. 1996) (court does not approve rejection of collective bargaining agreement, but does approve sale of substantially all the debtor's assets free and clear of any interest imposed by that agreement); *accord* After Six, Inc. v. Philadelphia Joint Bd. (*In re* After Six, Inc.), Nos. 93–11150S, 1993 WL 160385 (Bankr. E.D. Pa. 1993); *accord* New York Typographical Union No. 6 v. Maxwell Newspapers, Inc. (*In re* Maxwell Newspapers, Inc.), 981 F.2d 85 (2d Cir. 1992). The preplan sale free and clear process effectively guts whatever protection would otherwise be afforded by § 1114 and § 1129(a)(13). The only argument that can be made in support of this result is that it is the same result that would follow if the liquidation of the debtor's assets were to take place in a Chapter 7 case. *See In re* Ionosphere Clubs, Inc., 134 B.R. 515 (Bankr. S.D.N.Y. 1991) (recognizing that § 1114 does not apply to Chapter 7 cases and examining whether it should apply to liquidating Chapter 11 cases and concluding that, based on its plain language, it must, even though the legislative history suggests that Congress was not thinking that Chapter 11 included liquidating cases when it enacted the statute).

bankruptcy case unless they are creditors or interest holders.[128] There is, however, a very real danger that slow-moving government agencies that might otherwise object to or weigh in on a transaction may be unable to meaningfully participate in the process.[129] Because the sale free and clear of claims and interests will bar whatever successor-liability claims would otherwise exist in favor of the agency, the preplan sale procedure speeds the elimination of recourse to the assets involved unless it arises from a presale traditional in rem interest that the court will not strip off.

### D. The Context

All interest groups are affected differently by the choice of a § 363(f) preplan sale free and clear of claims and most interests rather than the plan confirmation process. Further, no two cases will present the same facts or the same effects. But the general pattern emerges: The rise of the preplan sale free and clear in place of the plan confirmation process magnifies the tendency for larger creditors and those with independent inside knowledge to benefit at the expense of smaller creditors and those lacking an independent source of information about the debtor and the transaction.[130] Any increased reliance upon an expedited preplan sale procedure enhances the interests of insiders, their professionals, secured creditors, and those who are intimately involved with the debtor. A relatively quick preplan sale instead of the plan process makes it more likely that smaller creditors and interest holders, as well as slower moving government agencies and the public at large, will be caught unaware and unrepresented.[131]

This development is contrary to many of the fundamental policies that underlie the bankruptcy process. Bankruptcy, under any chapter of the Code, is designed to be a collective proceeding in which the interests of the stake-holders in the debtor are weighed and balanced.[132]

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[128] *In re* O'Brien Envtl. Energy, Inc., 181 F.3d 527, 531 (3d Cir. 1999); G-K Dev. Co. v. Broadmoor Place Invs., L.P. (*In re* Broadmoor Place Invs., L.P.), 994 F.2d 744, 746 n.2 (10th Cir. 1993), *cert. denied*, 510 U.S. 1071 (1994); *but see In re* Colony Hill Assocs., 111 F.3d 269, 273 (2d Cir. 1997) (holding that an exception (and standing for an otherwise non-party-in-interest bidder) exists where the unsuccessful bidder alleges that the purchaser's actions destroyed the intrinsic fairness of the sale).

[129] Of course, the United States Trustee's Office monitors the case and, if appropriate, may alert or invite participation by other governmental agencies. *See* U.S. Trustee Manual, *supra* note 110, at §3-1.1 (U.S. Trustee's general case monitoring duties); *id.* at §3-4.2.4.2 (discussing overlapping roles of U.S. Trustees and Creditors' Committees); *id.* at §3-4.4.1.6 (discussing whether governmental units like the Pension Benefit Guaranty Corporation are eligible and should be invited to serve on a creditors committee).

[130] Although courts make bold pronouncements about maintaining protections for all parties — "[u]ndertaking reorganization piecemeal pursuant to § 363(b) should not deny creditors the protection they would receive if the proposals were first raised in the reorganization plan," Institutional Creditors of Cont'l Air Lines v. Cont'l Air Lines, Inc. (*In re* Cont'l Air Lines), 780 F.2d 1223 (5th Cir. 1986) — the above analysis demonstrates that this is not the case. Realistically, there is no substitute for the plan confirmation procedure that Congress initially established. Allowing short-circuits of that procedure through § 363(b) and (f) sales of substantially all the assets of a business unavoidably alters the balance of power between constituencies in Chapter 11.

[131] *Cf.* FED. R. CIV. P. 12(a) (providing nongovernmental parties with twenty days to file answer to complaint and sixty days for government parties).

Debtors and their insiders face extensive disclosure requirements and are subject to special scrutiny regarding prepetition transfers and dealings with the debtor as well as postpetition compensation and other transfers.[133] In Chapter 11, through the confirmation process, extensive disclosure is required prior to voting on the merits of a plan.[134] Even after this disclosure, there are a set of confirmation standards, some absolute and some flexible, that constrain the plan's terms so that minimum standards of treatment for all creditors and interest holders are met, no matter how small or unrepresented they are.[135] The use of § 363(f) sales free and clear to avoid these requirements and standards undermines the original balance of the Bankruptcy Code system, tilting the bankruptcy system toward debtors, insiders, and large secured creditors.

The expansive construction given to § 363(f), that assets can be sold "free and clear" of "claims," appears unlikely to change.[136] More likely, the increase in the use of Chapter 7 and 11

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[132] *See* S. REP. NO. 95-989 (1978), reprinted in U.S.C.C.A.N. 5787, 5800 (providing that the Code recognizes the "three-way tension" between the general creditor's interest in recouping their investment, the debtor's interest in a fresh start, and the tax collector's interest in raising revenue); H.R. REP. NO. 95-595 (1977), reprinted in U.S.C.C.A.N. (recognizing that one of the myriad policies in bankruptcy is the equality of treatment of all creditors); *see also* Rosemary Williams, *Annotation, Time and Method of Valuation under 11 U.S.C. § 506, of Security Held by Creditor of Bankruptcy*, 134 A.L.R. Fed. 439 (1996) ("When the Bankruptcy Code was enacted in 1978, the drafters labored long to ensure that rights and remedies provided to creditors and debtors by the statute were balanced."); Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 Harv. L. Rev. 1393, 1395 (1985) ("most of bankruptcy law is concerned not with defining a debtor's right of discharge, but with providing a compulsory and collective system for satisfying the claims of creditors"); *In re* Chavarria, 117 B.R. 582, 584 (Bankr. D. Idaho 1990) ("The Bankruptcy Code, by its very nature, is an attempt to balance the interests of debtors and their creditors.")

[133] *See* 11 U.S.C. § 343 (2000) (the debtor shall appear and submit to examination under oath at § 341 meeting of creditors and equity holders); 11 U.S.C. § 521 (2000) (the debtor must file a schedule of financial data and if a trustee is serving in the case, surrender to the trustee all the property of the estate and any recorded information, including books, documents, records, and papers relating to property of the estate regardless of whether immunity is granted under § 344); 11 U.S.C. § 547 (b)(4)(B) (2000) (providing that a transfer of an interest of the debtor in property made to an insider is a voidable preference if the transfer is made within one year of the petition date); 11 U.S.C. § 101 (13) (2000) (defining an "insider"); 11 U.S.C. § 1106 (2000) (a)(2)-(4) (where a trustee has been appointed, the trustee shall file the § 521 disclosures, investigate relevant data about the debtor, file a statement of investigation including any irregularity in the management of the affairs of the debtor); 11 U.S.C. § 1107 (2000) (saddling debtor in possession with § 1106 duties); 11 U.S.C. § 1125 (2000) (a disclosure statement containing adequate information enabling a hypothetical reasonable investor to make an informed judgment about the plan); 11 U.S.C. § 1129 (a)(4) and (5) (2000) (requiring disclosure and court approval of certain payments made or to be made in connection with the plan or the case along with the disclosure of the identity of any director, officer, voting trustee, or insider that will be employed or retained by the reorganized debtor and the nature of any compensation for such insider).

[134] *See* 11 U.S.C. § 1125 (2000) (court finding that disclosure statement provides "adequate information" is prerequisite to soliciting acceptances and rejections of plan).

[135] *See* 11 U.S.C. § 1123 (2000) (what must and may be included in a plan); 11 U.S.C. § 1125 (2000) (prohibition on solicitation of acceptances and rejections of plan until court has approved disclosure statement as containing "adequate information"); 11 U.S.C. § 1129 (2000) (confirmation standards).

[136] Of course, the circuit courts of appeals and the United States Supreme Court could work a sea of change of this magnitude. However, the effectiveness of § 363(m) and current "speedy close" practice in mooting appeals makes it seldom that appeals get that far. Declaratory relief actions brought by a debtor as a precondition to a sale might present the opportunity for meaningful judicial review. *See, e.g.*, Allstate Ins. Co. v. Mercier, 913 F.2d 273, 277 (6th Cir. 1990) (a declaratory judgment may be appropriate under the Declaratory Judgment Act of 1934, 28 U.S.C. §

proceedings to effect the sale and purchase of a business or its assets will continue, with counsel and business clients increasingly using the bankruptcy process to limit exposure to unknown liabilities, and with bankruptcy courts increasingly asked to provide a shield for purchasers from the claims of the debtor's creditors.[137] In some senses, the bankruptcy system is being used to solve the problem caused by purchasers' inability to take much comfort in the representations, warranties, and indemnities of the seller of a business, whether failing or not, or of its principals. A free-and-clear order that is final and nonappealable, backed up by the Bankruptcy and Supremacy Clauses of the United States Constitution, and entitled to full faith and credit in federal and state courts across the country is an effective tool indeed. By foreclosing claims as a matter of law, there is no need for the parties to design an effective transactional mechanism to allocate risk between them — § 363(f) as interpreted eliminates the risk. The losers under this scheme are successor-liability claimants, smaller, low priority creditors, and slow-moving entities and agencies.[138]

### E. Why 363 Needs Fixing

#### 1. Sub Rosa plan.

The sale of substantially all of a debtor’s assets prior to a disclosure statement and plan being proposed results in the elimination of the traditional safeguards of good faith, transparency, fairness, equity, and creditor acceptance built into the plan process, through the specific findings that are necessary for confirmation under 1129.

#### 2. Fairness.

Court approval of a 363 sales is based on the debtor showing only “business justification” or “a good business reason;” whether the sale is in the best interest of creditors is not necessarily a factor considered.

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2201 (2000), where it will serve a useful purpose in clarifying the legal relations in dispute and it will afford relief from the uncertainty, insecurity, and controversy giving rise to the proceedings). But this is exactly why they are not and will not be brought.

[137] *But see* Paul Traub, *Value and Cents: Strategic Disposition of Assets - Sometimes the Best Deal Isn't on the Courthouse Steps*, 17 Am. Bankr. Inst. J. 26 (Nov. 1998) (detailing benefits of nonbankruptcy strategic asset dispositions).

[138] This may be yet another example of the trend towards the elimination of any real liability of incorporeal entities beyond their insurance policies. *See* Lynn M. LoPucki, *The Death of Liability*, 106 Yale L.J. 1 (1996) (arguing that American businesses are rendering themselves judgment proof because of the ease with which a modern debtor can grant secured credit, the growth of asset securitization, the availability of foreign havens for hiding assets, and the traditional ways of avoiding legal liability, such as scattering assets among subsidiaries); but see James J. White, *Corporate Judgment Proofing: A Response to Lynn LoPucki's The Death of Liability*, 107 Yale L.J. 1363 (1998) (arguing that American businesses are not judgment proof and pointing to data showing that public companies grant much more modest levels of security than would be necessary to become judgment proof, that most companies have lien-free assets that greatly exceed their liabilities, and that most companies carry substantial amounts of liability insurance). To correct this trend under the existing statute, courts should hew to the plain meaning of the statute, recognize that when Congress wanted to speak of claims and interests it did so, and that postconfirmation vesting of property free and clear of claims and interests under a confirmed and consummated plan is the proper route to achieve this end.

3. Who Benefits?

The debtor, its secured creditors, and professionals primarily benefit from asset sales that are followed by liquidation. The stalking horse bidder benefits by virtue of greater access to information and therefore holds a superior position to other potential bidders. After a sale, creditor recovery under the plan allocating the sale proceeds typically is far less than the cherry-picked creditors whose liabilities are assumed by the buyer in the sale.

4. Not Arm's Length.

An asset sale is most unfair when (1) a purportedly competitive third-part purchaser is an insider or affiliate, (2) the "bidding" is not truly competitive, or (3) the purchaser merges with or merely continues the business while its successor liability is cut off without regard to applicable non-bankruptcy law.

5. Lack of Transparency.

Asset sales, particularly ones done urgently, do not sufficiently identify either the precise assets being sold free and clear, or the specific interest being affected. Debtors can complete sale arrangements prepetition – including setting artificial deadlines with the buyer – and then use those same deadlines to force the process forward in its own and the buyer's best interests, rather than in the best interests of creditors.

6. Broad Interpretation of "Free and Clear of Interests."

Courts broadly construe 363(f) to find certain governmental interests to be "interests in such property" from which the assets can be sold "free and clear" – when those interests are statutory requirements and are not per se interests in the assets being sold. Courts are reading the term "free and clear of any interest in such property" to include any kind of liability or obligation, including experience ratings, environmental liability (purchaser as successor), tort and products liability claims, pension funding obligations, non-monetary rights such as the ability to use standby travel vouchers, etc.[139]

[139] *In re* Leckie Smokeless Coal, 99 F.3d 573 (4th Cir. 1996) (debtor coal mine operators could see assets free and clear of pension benefit obligations under the Coal Act because assets being sold were still to be used for coal mining purposes); *In re* Trans World Airlines, 322 F.3d 283 (3d Cir. 2003) (assets sold "free and clear" of employee travel voucher claims, government discrimination claims against TWA because the airline assets being sold were "related to" the discrimination claims at issue); *In re* Colarusso, 295 B.R. 166 (B.A.P. 1st Cir. 2003) (363's phrase "interest in such property" covers more than in rem interests and is at least as broad as the term "property of the estate" under Section 541); *In re* Chrysler, 576 F.3d 108 (2d Cir. 2009) (Old Chrysler's assets were sold potentially "free and clear" of New Chrysler's successor liability for future tort claims caused by Old Chrysler's cars); *In re* General Motors, 407 B.R. 463 (Bankr. S.D.N.Y. 2009) (same, relying on Chrysler); In re PBBC, 484 B.R. 860 (1st Cir. B.A.P. 2013) (asset purchaser not subject to debtor's "experience rating" –used to calculate purchaser's future

7. Sale for Purpose of Eliminating Liability.

Asset sales are being specifically used for the purpose of eliminating a range of the debtor's and the purchaser's compliance obligations, including products and environmental liabilities, contractual, pension, labor, and tax obligations.[140]

8. No Stay/ No Appeal Rights.

Sale orders routinely eliminate or significantly shorten the 14-day stay provided in rule 6004(h), which results in immediate statutory mootness of any objector's appeal under 363(m).[141]

F. Why Amending the Code is the Proper Solution

Very few statutory amendments are needed to put an explicit non-plan sale procedure into effect.[142] The key is to properly define a "non-plan sale" and then to amend the substantive statutes and rules involved, providing a process for such a sale that mimics the plan confirmation process enough to satisfy due and appropriate process requirements at the least possible expense in terms of time and money.[143] By using a process that is procedurally parallel to the plan confirmation process, this non-plan sale process would be familiar to, and draw upon, well-

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unemployment insurance tax rates for its own operations – because rating was an "interest," of which debtor's assets could be sold free and clear); *In re* Tougher Industries, 2013 Bankr. LEXIS 1228 (Bankr. N.D.N.Y 2013) (same). *But see In re* Grumman Olson, 467 B.R. 694, 702-03 (S.D.N.Y. 2012 ("free and clear" sale order did not prevent plaintiffs from pursuing successor liability tort claims against 363 asset purchaser, based on post-petition injuries suffered while driving a truck made pre-petition because enforcing the order would deny plaintiff's due process); Folger Adam Security, Inc. v. DeMatteis, 209 F.3d 252, 258 (3d Cir. 2000) (affirmative defenses of setoff/recoupment are not "interests in property" from which assets were sold free and clear); *In re* Fairchild Aircraft, 184 B.R. 910, 917-19 (Bankr. W.D. Tex. 1995) vacated on other grounds, 220 B.R. 909 (Bankr. W.D. Tex. 1998) (tort action based on post confirmation injuries cause by defective plane manufactures prior to bankruptcy was not barred against asset purchaser because such an action was not an "interest in" the assets sold; claims are not interests in the property; only in rem rights are covered); Ninth Avenue Remedial Group v. Allis-Chalmers Corp, 195 B.R. 716, 730-34 (N.D. Ind. 1996) (363 applies to in rem interests in property and not CERCLA cause of action that had not arisen during the pendency of the bankruptcy; approval of asset sale "free and clear" does not affect or discharge environmental claims brought later against the purchaser under successor liability theory); Zerand-Bernal v. Cox, 23 F.3d 159, 162-64 (7th Cir. 1994) (363(f) does not bar products liability action against asset purchaser because such an action was not an effort to enforce a lien from which assets were free and clear; bankruptcy court does not have power to order such a release of liability for the successor if it exists); *In re* Wolverine Radio, 930 F.2d 1132, 1147 (6th Cir. 1991) ("interest" under 363 is one that attaches "to the property so as to cloud its title." Thus debtor's past experience rating was not an "interest").

[140] *C.f. In re* Eveleth Mines, 318 B.R. 682 (B.A.P. 8th Cir. 2004) (under Tax Injunction Act bankruptcy court must abstain when State-law tax issues are raised in motion to enforce 363 sale order free and clear of tax calculation; reversing on jurisdictional grounds bankruptcy court's underlying refection of Leckie and TWA, and holding that State tax action against the 363 purchaser of a debtor's mine was not barred by sale because tax calculation was no an "interest in" the property sold).

[141] *See* George W. Kuney, *Slipping into Mootness*, 2007 NORTON AM. SURVEY OF BANKR. L., Part 1, §3 (West 2007).

[142] Kuney, *supra* note 79, at 1286.

[143] *Id.*

developed precedent from bankruptcy courts and practitioners nationwide. But by focusing on just the disposition of certain assets in the process, rather than the plethora of issues, transactions, and distributions implicated in a full-blown plan of reorganization, the process should be efficient enough to avoid becoming the murky, sticky bog that Chapter 11 reorganization-by-plan can become.[144]

Providing explicit statutory authority for these sales will remove whatever objections may be made based upon the lack of such provisions under the existing statute.[145] Explicit statutory authority would also promote national uniformity and predictability for non-plan sales of substantially all the assets of an estate or a business.[146] Implementation of this uniform process would help to level out the disproportionate impact of preplan sales on various constituencies.[147]

These goals are desirable considering that the non-plan sale method of effectuating a reorganization or exiting from Chapter 11 is the only method not covered specifically by the statute.[148] Conversion to Chapter 7, dismissal, and plan confirmation are all provided for, and the result has been the development of a nationwide body of authority addressing their permutations.[149] Given the importance of non-plan sale practice today, it makes no sense to have this fourth route out of Chapter 11 undefined except by the patchwork of jurisdiction-specific practices and precedent and local rules formulated on the local district and division levels nationwide.[150]

Because the Code and the Federal Rules of Bankruptcy Procedure were not drafted with a non-plan sale of substantially all the assets of a business in mind as a Chapter 11 reorganization strategy, no cohesive regimen or bright-line rules regarding the substance or procedure of such a sale have emerged on the following questions: what is proper notice of the sale and opportunity to object or overbid; what are proper overbidding procedures and limitations; and, when and what kind of break-up fees and other stalking-horse protections are appropriate.[151] Formalizing nonplan sale practice and importing the concept of “adequate information” from § 1125 should increase uniformity and the understanding of the standards to be applied to address procedural

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[144] *Id.* at 1286-87

[145] *Id.* 1287

[146] *Id.* at 1288

[147] *Id.*

[148] *Id*.

[149] *Id.*

[150] Kuney, *supra* note 79, at 1288

[151] *Id*. at 1290-91

and substantive concerns.[152] The amendments would also make it clear that a Chapter 7 or other trustee can sell assets free and clear of interests and claims, rather than just interests, a term that is not defined under the Bankruptcy Code.[153] The existing national patchwork of nonplan sale procedures and the failure of Congress and the Rules Committee to address the practice is an invitation for abuse and confusion.[154] The reorganization market has demanded this process, and it is time for Congress to provide for a uniform, national procedure that suitably accommodates the competing interests involved.[155]

### G. Proposed Amendments and Fixes to the Code

As a preliminary matter, it is best to define this procedure from the outset, therefore § 101 (definitions) requires a new definition for this procedure, a nonplan sale.[156] The power of the court section of the statute (§ 105) should be amended to explicitly give bankruptcy judges the whip hand to control cases by ordering such a sale. [157]

Section 363 also would need to be amended. In order to achieve the goal of making the sale process parallel to the plan process as an exit strategy for Chapter 11, it is appropriate to focus on adequate disclosure, notice, and approval of the sale. Thus, it appears prudent to borrow from the plan and disclosure statement process to import § 1125(a)'s "adequate information" standard and its established precedent into the first of two hearings, the one at which the "stalking horse" bidder's proposed purchase and opportunity for overbidding is presented to the court and parties in interest.[158] The amendments should answer the following questions: (1) did pre-bankruptcy planning include the sale of substantially all assets? (2) was a stalking horse identified pre-petition and what agreements were made at that time (breakup fees, timing of sale, etc.)? (3) What were the pre- and/or post-bankruptcy marketing efforts undertaken? (Identify other prospective buyers who expressed interest) (4) What claims will be satisfied by the sale and what is the 506(a) value of those claims? Section 363 subsection (f) should be amended to (1) make it clear that non-plan sales can be free and clear of claims as well as interests and (2) augment the five conditions for sales free and clear with an explicit reference to the adequate protection standard of § 363(e).[159] The amendment should require that when substantially all of the debtor's assets are to be sold outside of a plan, good cause must be shown, including: (a) the sale is in the best interest of creditors and will result in a greater recovery under the liquidation plan; (b) the assets were marketed in accordance with generally accepted practices in the

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[152] *Id.* at 1291

[153] *Id.* at 1287

[154] *Id*. at 1304

[155] *Id*. at 1305

[156] *Id.* at 1288

[157] *Id.*

[158] *Id.* at 1289

[159] *Id.* at 1291

industry; and (c) there is a factual basis for urgency, which is not debtor/buyer-created.

To reign in and bring clarity to expansive readings of 363(f), section 363 should be amended to: (1) clarify that "interest in property" means only direct in rem interests (liens, security interests, encumbrances, ownership interests) in the assets being sold for which the creditor can be required to accept money in satisfaction under non-bankruptcy law; (2) specifically require that interests attach to the proceeds in the same order and priority as under non-bankruptcy law; and (3) exclude claims or interests that a party may be able to assert against a purchaser as a successor under applicable non-bankruptcy law. These amendments bring consistency to 363 with the usage of the term "interest" under the rest of the Code. They also limit free and clear sales to interests that can be forced to accept monetary payments (resolving issues associated with easements and covenants and whether they can be eliminated by a free and clear sale), and this eliminates cherry-picking by debtor and/or buyer to pay some creditors preferentially (e.g., by liability assumption), but not pay others who may hold claims in a similar class – or even higher priority. Additionally, the amendments clarify that successorship rights and liabilities are not affected by free and clear sale except as allows by non-bankruptcy law, clarify that buyers cannot avoid their own liabilities under non-bankruptcy law that do not arise from claims against the debtor, preserve due process right of future claimants (tort, products liability, environmental), and add a clear statement about interest attaching to proceeds.

With the amendment of § 363(b) and (f) to allow non-plan sales of the business free and clear of interests and claims, Rule 4001 will also require revision. Again, in order to reduce confusion and draw upon an existing body of law, the procedure for approving non-plan sales should, as much as possible, parallel that for obtaining credit under Rule 4001(c).[160] The fourteen-day period of Rule 4001(c) (2) should be lengthened to thirty days to allow a more realistic opportunity for all affected parties to review and respond to the motion to obtain credit or for approval of the sale before the interim order can become final and to allow better opportunity for affected parties to review and respond to the motion for final approval of the sale.[161] Additionally, to eliminate the problem of stay/statutory mootness, Rule 6004 (Use, Sale, or Lease of Property) should be modified to require good cause shown for any waiver or shortening of the stay, and to provide that a provision calling for such a waiver or shortened time in the purchase agreement or other agreement between the debtor and the purchaser is insufficient to create good cause.

It is appropriate to amend the definition of "substantial consummation" (§§ 1101, 1103, 1106, and 1112) to apply to these sales as well as to plans to provide finality and protection for the purchaser.[162] Amending § 1114 (payment of insurance benefits to retired employees) to extend the same protections to retirees under a non-plan sale as they would enjoy under plan confirmation.[163] Those who are authorized to file a plan (§ 1121) should also be able to file a

[160] Kuney, *supra* note 79, at 1293

[161] *Id.* at 1295, 1297

[162] *Id.* at 1297

motion to approve a proposal for a nonplan sale. Those that cannot, should not. [164] Section 1125 (a) (postpetition disclosure and solicitation) should be amended to include the proper non-plan sale.[165] Extending the same protections to those that appropriately solicit support or opposition to a plan (§ 1125(e)) to those doing so for a non-plan sale and competing overbids to the stalking horse bidder makes good sense. Section 1126 (acceptance of plan) should be amended to make it clear that it is the court that approves or disapproves a non-plan sale and that the substance and procedure of the process is that of § 363(b) and, if applicable, (f).[166] However, to balance the goals of these amendments with the rights of those not before the court, Section 363 should be amended to provide that: (1) nothing in the order approving a sale shall affect the purchaser's future liability under applicable State or federal law, and (2) the debtor and purchaser may request a determination based on a factual record and pursuant to applicable law that successorship does not result, but may not simply eliminate liability in a factual and legal vacuum.

Continuing with the goal of paralleling the plan process, the postconfirmation vesting powers and the plan implementation statutes (§§1141 and 1142) should be amended to include nonplan sales. This, combined with the modification of § 363(f) to expressly allow non-plan sales free and clear of claims as well as interests, will bring non-plan sale practice into line with plan sale practice.[167] Section 1146 (special tax provisions) should be amended in two places ((c) and (d)) to ensure that the non-plan sale process offers the same substantive and procedural benefits as the plan process.[168]

To remedy the "Wrong Chapter" problem, Rule 6004 should be amended to provide that when a "substantially all" asset sale is proposed, an 1104 trustee is appointed to fulfill the following limited duties: (1) to obtain limited DIP financing for a 3-4 month period and limit professional fees; (2) to evaluate the value of the assets to be sold and the liens/interests in those assets; (3) to asses creditor recovery under reorganization versus liquidation; (4) to assure competitive bidding and an arm's length transaction; and (5) to move the debtor to a Chapter 7 depending on the results of the trustee evaluation/assessment.

To remedy the "Lack of Transparency" problem, Rule 6004 should be amended to require the sale motion to list the precise assets being sold and to identify the specific interests affected, making clear which of the seller's environmental, pension, contractual and other obligations the purchaser intends to assume, which liabilities will remain with the debtor, which liabilities will be satisfied (or not) by the proceeds from the sale, and whether the buyer asserts it

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[163] *Id*. at 1298-99

[164] *Id*. at 1299

[165] *Id.* at 1301

[166] *Id.* at 1302

[167] *Id.* at 1303

[168] *Id.* at 1304

is exempt from any statutory liabilities by reason of having bought the assets in the 363 sale.

To eliminate sales entered into solely to avoid liability, Section 363 should borrow the intention behind the protective language in 1129(d), which prohibits confirmation if the plan's principle purpose is tax or securities law avoidance. Section 363 should be amended to provide that: "on request of a party in interest that is a governmental unit, the court may not approve a sale of substantially all of the debtor's assets if the principal purpose of the sale is the avoidance of environmental or other liability to a governmental unit under State or federal laws."

Finally, to eliminate problems associated with the transfer of permits, Section 363 should be amended to provide that: "Nothing in an order approving an asset sale shall authorize the transfer or assignment to the purchaser of any license, permit, registration, authorization, or approval issued by a governmental unit except in accordance with applicable non-bankruptcy law governing such transfer or assignment." This ensures the protection of the public by requiring government approval of permit transfers and ensures that the purchaser becomes known to the regulator before closing.