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## THE PRECEDENTIAL VALUE OF AN UNPRECEDENTED SALE - LESSONS FROM CHRYSLER

On June 10, 2009, the sale of substantially all of Chrysler's assets closed, just 42 days after the country's third largest automaker filed for bankruptcy protection. The closing followed a contentious sale hearing before the Bankruptcy Court, an expedited appeal to the Second Circuit Court of Appeals and a brief stay imposed by the United States Supreme Court. The source of the contention: three Indiana state pension funds, arguing that the sale of Chrysler's assets constituted a *sub rosa* plan of reorganization that upended the priority scheme of the Bankruptcy Code. Rejecting the Indiana pension funds' arguments and approving the sale, a decision upheld on appeal, the Bankruptcy Court avoided mention of the effect of unprecedented governmental intervention in its analysis, relying on its interpretation of applicable bankruptcy law. As the sale process in the bankruptcy of General Motors nears completion, much has been learned from Chrysler.

### The Chrysler Sale Transaction and Indiana Pensioners' Objections

Chrysler LLC and 24 of its domestic direct and indirect affiliates filed for Chapter 11 protection on April 30, 2009 in the United States Bankruptcy Court for the Southern District of New York. Shortly thereafter, Chrysler filed a motion seeking approval of the sale of substantially all of its operating assets to "New Chrysler" in exchange for \$2 billion in cash and the assumption of certain liabilities. As part of the transaction, New Chrysler entered into two agreements with the UAW: a new collective bargaining agreement in which the UAW made unprecedented concessions and a settlement agreement relating to a 2008 class action that established a voluntary employees' beneficiary association, or VEBA, to fund legacy retiree health care obligations. Pursuant to the settlement agreement, the VEBA would be funded with a 55% membership interest in New Chrysler and a new \$4.587 billion note. The remaining membership interests in New Chrysler would be issued to U.S. and Canadian governmental entities and a subsidiary of Fiat S.p.A. Ultimately, New Chrysler would be funded entirely by the U.S. and Canadian governments, contributing \$6 billion in senior secured financing to support New Chrysler's operations after the sale.

The Indiana pension funds which challenged the sale held approximately \$42 million (less than 1%) of Chrysler's \$6.9 billion first-priority secured debt pursuant to an Amended and Restated First Lien Credit Agreement secured by substantially all of Chrysler's assets. The Indiana pension funds raised multiple objections to the proposed sale, including that it violated the Emergency Economic Stabilization Act of 2008

and the Troubled Asset Relief Program. However, its primary complaint was that the sale transaction constituted a *sub rosa* plan of reorganization that violated the priority scheme of the Bankruptcy Code because it sold all of the first lien lenders' collateral and essentially distributed the proceeds of the sale to unsecured trade creditors and the UAW.

### **Lesson One: A Quick Sale is Nothing More Than a Quick Sale**

Section 363 of the Bankruptcy Code authorizes a debtor-in-possession, after notice and a hearing, to use, sell or lease property of the estate outside of the ordinary course of its business. However, a sale of assets under section 363 that, in essence, would direct or effectuate the terms of a reorganization plan is considered an impermissible *sub rosa* plan of reorganization. The rationale for barring such attempts is that they deprive creditors of the comprehensive protections normally afforded to them in the plan confirmation process, including formal disclosure, an opportunity to vote on acceptance and a fully noticed confirmation process. While a section 363 sale requires court approval and gives creditors the right to object, the more stringent and time-consuming plan confirmation requirements are not present. Thus, where a section 363(b) sale would preempt or dictate the terms of a plan, the sale should not be authorized. The Indiana pension funds argued that the Chrysler sale transaction was a *sub rosa* plan of reorganization in that it would sell their collateral to New Chrysler, which would use it to satisfy over \$20 billion in unsecured creditor claims, leaving the first lien lenders with only 29% of the value of its collateral.

In rejecting this argument, the Court noted that the standard in the Second Circuit for determining whether to authorize a section 363 sale prior to and outside of the plan confirmation process is, simply, whether there was a "good business reason" for such a sale. The Court held there was an articulated business justification for the sale and for the necessity of completing it quickly. Moreover, the Court held that the sale was not a *sub rosa* plan of reorganization because the Debtors were receiving fair value for the assets being sold and *all* of the proceeds from the sale would be paid to the first lien lenders.

### **Avoiding Violations of the Priority Scheme**

Chapter 11 of the Bankruptcy Code requires, among other things, that a plan be fair and equitable and not discriminate unfairly among similarly situated creditors. The absolute priority rule, a fundamental principle of U.S. bankruptcy law, provides that a plan is fair and equitable if an unsecured creditor or other priority creditor receives full value for its claim or, if it does not receive full value, that the holder of any junior claim will not receive any property on account of such junior claim. The words 'fair and equitable' are terms of art meaning senior interests and claims are entitled to full priority over junior ones. The Indiana pension funds argued that allowing Chrysler "to ignore the priority scheme established by the Bankruptcy Code while selling substantially all of their assets, in permanent derogation of the Indiana Pensioners' property rights, would turn the law on its head." Specifically, they argue that the sale violates the priority scheme of the

Bankruptcy Code because (i) the first lien lenders will be not be paid in full while U.S. and Canadian governmental entities, junior lienholders under Chrysler's TARP debt, will receive value; and (ii) the first lien lenders' \$4.9 billion unsecured deficiency claim will ultimately be treated differently than the general unsecured claims of certain trade creditors and the UAW.

In rejecting these arguments, the Court emphasized three points. First, the membership interests in New Chrysler were not issued to the UAW and the U.S. and Canadian governments on account of their prepetition claims, but rather were issued as consideration for the contribution of new value. The U.S. and Canadian governments are providing New Chrysler with approximately \$6 billion in funding, while the UAW is providing New Chrysler with a skilled workforce under a more competitive cost structure and a more restrictive collective bargaining agreement. Second, the membership interests in New Chrysler were issued pursuant to agreements between each party and New Chrysler, and not Chrysler as debtor. The consideration provided by New Chrysler was not value that would otherwise inure to the benefit of Chrysler's estate, so the agreements did not divert value from Chrysler's estate or allocate proceeds from the sale of its assets. Finally, parties to contracts that are assumed in a bankruptcy case are entitled to cure payments and adequate assurance of future performance -- the Bankruptcy Code recognizes that certain creditors may receive more favorable treatment than other creditors, either in their class or a higher priority class, as part of a sale, and that such disparate treatment does not violate the priority rules.

#### Adequacy of Notice is in the Eye of the Beholder

Rule 2002 of the Bankruptcy Rules requires at least 20 days notice of a section 363 sale, unless otherwise ordered by the Court. While the Chrysler sale hearing began more than 20 days after Chrysler filed its sale motion, the Indiana pension funds, as well as many other parties, objected to the abbreviated and rushed sale process. As the Indiana pension funds stated in their objection, Chrysler "acted as if they were selling a Chrysler LeBaron and not a multinational corporation with billions of dollars in assets." They argued that the sale process effectively precluded anyone but New Chrysler from bidding on Chrysler's assets, was inherently unfair and failed to maximize the sale price.

In holding that the notice provided was adequate, the Court focused on the need for expedited relief to prevent the erosion of the value of Chrysler's assets. The Court found that despite the complexity of the transaction, notice of the sale was adequate where information about Chrysler's troubles were known worldwide prior to the bankruptcy, there had already been an extensive marketing attempt, and the assets were "wasting" away. Adequacy of notice is to be judged on what is adequate under the circumstances of each case.

#### **The Lessons**

The Chrysler bankruptcy case demonstrate the flexibility of the Bankruptcy Code, which has permitted Bankruptcy Courts to adapt to and confront the challenges and turmoil of these unprecedented economic times. The Bankruptcy Court's decision to approve the Chrysler sale transaction relied upon the familiar values underlying U.S. bankruptcy law: equity, rehabilitation and the right to a fresh start. Although other Bankruptcy Courts, faced with less dire consequences, may act with more deliberation, the effect of the Chrysler bankruptcy case, and the precedent it has set, is undeniable.

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